NEW ISSUES - BOOK-ENTRY ONLY

RATINGS: **Moody's: A3**
S&P: AA-
Fitch: A
(See "RATINGS" herein)

In the opinion of Bond Counsel to the State as described herein, under existing statutes and court decisions and assuming continuing compliance with certain tax covenants, interest on the Offered Veterans G.O. Bonds (a) (i) is excluded from gross income for Federal income tax purposes pursuant to Section 103 of the Internal Revenue Code of 1986, as amended (the "Code") and (ii) is exempt from State of California personal income taxes, (b) interest on the Series CA Bonds is not treated as a preference item for purposes of calculating the alternative minimum tax imposed on individuals and corporations under the Code; such interest, however, is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations, and (c) interest on the Series CB Bonds is treated as a preference item for purposes of calculating the alternative minimum tax imposed on individuals and corporations under the Code. See "TAX MATTERS" herein.

$221,475,000
STATE OF CALIFORNIA
VETERANS GENERAL OBLIGATION BONDS
$16,000,000 Series CA (Non-AMT)
$205,475,000 Series CB (AMT)

Dated: April 1, 2005 **Due: As shown below**

This offering consists of veterans general obligation bonds listed above (the "Offered Veterans G.O. Bonds") authorized by the voters of the State of California (the "State").

Interest is payable on June 1 and December 1 of each year, commencing December 1, 2005. The Offered Veterans G.O. Bonds may be purchased in book-entry form only, in the principal amount of $5,000 or any integral multiples thereof. See APPENDIX C – "DTC AND THE BOOK-ENTRY SYSTEM." The Offered Veterans G.O. Bonds are subject to redemption prior to maturity, including redemption at par. See "THE OFFERED VETERANS G.O. BONDS– Redemption."

SERIES CA MATURITIES, PRINCIPAL AMOUNTS, INTEREST RATES AND CUSIPS

Maturity Date (December 1)	Princpal Amount	Interest Rate	CUSIP
2017	$7,000,000	4.45%	13062RHP6
2018	9,000,000	4.50	13062RHQ4

SERIES CB MATURITIES, PRINCIPAL AMOUNTS, INTEREST RATES AND CUSIPS

Maturity Date (December 1)	Principal Amount	Interest Rate	CUSIP	Maturity Date (December 1)	Principal Amount	Interest Rate	CUSIP
2011	$10,315,000	4.00%	13062RHR2	2015	$ 405,000	4.50	13062RHV3
2012	10,335,000	4.15	13062RHS0	2016	430,000	4.65	13062RHW1
2013	10,355,000	4.30	13062RHT8	2017	26,225,000	4.70	13062RHX9
2014	380,000	4.40	13062RHU5	2018	27,030,000	4.75	13062RHY7

$26,000,000 4.90% Series CB Term Bond due December 1, 2025, CUSIP No. 13062RHZ4
$94,000,000 5.05% Series CB Term Bond due December 1, 2036, CUSIP No. 13062RJA7
Price of all Offered Veterans G.O. Bonds: 100%
(plus accrued interest)

The Offered Veterans G.O. Bonds are general obligations of the State to which the full faith and credit of the State are pledged. Principal of, premium, if any, and interest on all State general obligation bonds, including the Offered Veterans G.O. Bonds, are payable from any moneys in the General Fund of the State, subject only to the prior application of such moneys to the support of the public school systems and public institutions of higher education. State law requires that funds for the payment of debt service on the Offered Veterans G.O. Bonds be transferred to the General Fund from the Veterans Farm and Home Building Fund of 1943. See "AUTHORIZATION OF AND SECURITY FOR THE OFFERED VETERANS G.O. BONDS – Security For and Payment of Veterans G.O. Bonds."

This cover page contains certain information for quick reference only. It is *not* a summary of this issue. Investors must read the entire Official Statement to obtain information essential to the making of an informed investment decision.

The Offered Veterans G.O. Bonds are offered when, as and if issued and received by the Underwriters set forth below, subject to certain conditions, including the receipt of certain legal opinions of the Honorable Bill Lockyer, Attorney General of the State of California, and of Hawkins Delafield & Wood LLP, Bond Counsel to the State. In connection with the issuance of the Offered Veterans G.O. Bonds, Gardner Underwood & Bacon LLC has served as Pricing Advisor, Quateman & Zidell LLP has served as Disclosure Counsel to the State, and Sidley Austin Brown & Wood LLP has served as Special Counsel to the State regarding APPENDIX A. Certain legal matters will be passed upon for the Underwriters by their counsel, Kutak Rock LLP. The Offered Veterans G.O. Bonds will be available for delivery on or about April 28, 2005.

Honorable Philip Angelides
Treasurer of the State of California

Bear, Stearns & Co. Inc.

Lehman Brothers **Merrill Lynch & Co.**

Dated: April 12, 2005.

No dealer, broker, salesman or other person has been authorized by the Department of Veterans Affairs or the Underwriters to give any information or to make any representations with respect to the Department of Veterans Affairs or its Offered Veterans G.O. Bonds other than those contained in this Official Statement and, if given or made, such other information or representations must not be relied upon as having been authorized by any of the foregoing. The information set forth herein has been obtained from sources which are believed to be current and reliable. Estimates and opinions are included and should not be interpreted as statements of fact. Summaries of documents do not purport to be complete statements of their provisions and such summaries are qualified by references to the entire contents of the summarized documents. The information and expressions of opinion herein are subject to change without notice, and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Department of Veterans Affairs since the date hereof.

This Official Statement is not to be construed as a contract with the purchasers of the Offered Veterans G.O. Bonds.

The information set forth herein has been furnished by the Department and other sources which are believed to be reliable, but is not guaranteed as to accuracy or completeness. The information and expressions of opinions herein are subject to change without notice and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Department since the date hereof.

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY OVERALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF THE OFFERED REVENUE BONDS AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

Copies of this Official Statement may be obtained from:
HONORABLE PHILIP ANGELIDES
Treasurer of the State of California
P.O. Box 942809
Sacramento, California 94209-0001
(800) 900-3873

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OFFICIAL STATEMENT

$221,475,000

STATE OF CALIFORNIA

VETERANS GENERAL OBLIGATION BONDS

$16,000,000 Series CA (Non-AMT)

$205,475,000 Series CB (AMT)

INTRODUCTION

This Introduction contains only a brief summary of the terms of the State of California Veterans General Obligation Bonds Series CA (the "Series CA Bonds") and Veterans General Obligation Bonds Series CB (the "Series CB Bonds" and together with the Series CA Bonds, the "Offered Veterans G.O. Bonds") and a brief description of the Official Statement; a full review should be made of the entire Official Statement, including the Appendices and information incorporated by reference. All statements contained in this introduction are qualified in their entirety by reference to the entire Official Statement. Summaries of provisions of the Constitution and laws of the State of California or any other documents referred to in this Official Statement do not purport to be complete and such summaries are qualified in their entirety by references to the complete provisions.

Description of the Offered Veterans G.O. Bonds

The issuance of veterans general obligation bonds ("Veterans G.O. Bonds") is authorized by Bond Acts (defined below) approved by the voters of the State of California (the "State") and by resolutions of the Veterans Finance Committee of 1943. The Offered Veterans G.O. Bonds are authorized by specific Bond Acts and are being issued to finance, or to refinance obligations that were issued to provide funds for the financing of, contracts ("Contracts of Purchase") for the purchase of homes and farms for California military veterans under the Farm and Home Purchase Program (the "Program") of the Department of Veterans Affairs of the State (the "Department"). The Offered Veterans G.O. Bonds are being issued for the purposes of (i) reimbursing the Department for existing Contracts of Purchase previously funded by the 1943 Fund; and (ii) refunding certain outstanding Veterans G.O. Bonds and/or State commercial paper. See "THE OFFERED VETERANS G.O. BONDS – Purpose" and "– Identification and Authorization of the Offered Veterans G.O. Bonds."

The Department anticipates that contemporaneously with the issuance of the Offered Veterans G.O. Bonds the Department will issue $42,600,000 of the Department's Home Purchase Revenue Bonds, 2005 Series A (the "2005 Revenue Bonds"). The Offered Veterans G.O. Bonds and the 2005 Revenue Bonds are separate and independent bond issues, although they are treated as a single issue for certain Federal tax purposes. The sale and issuance of the Offered Veterans G.O. Bonds is not dependent upon the sale and issuance of the 2005 Revenue Bonds. The Offered Veterans G.O. Bonds and the 2005 Revenue Bonds will each be offered and sold pursuant to a separate official statement, copies of which, when available, may be obtained from the Department (see "Additional Information").

See EXHIBIT 2 TO APPENDIX B – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Veterans G.O. Bonds and Revenue Bonds – Selected Information with Respect to Veterans G.O. Bonds and Revenue Bonds" for information about Veterans G.O. Bonds and Revenue Bonds expected to be refunded and "– Contracts of Purchase – Amounts Expected to be Available to Fund Contracts of Purchase and Related Investments" for information regarding the amount of money expected to be made available to finance Contracts of Purchase upon the issuance of the Offered Veterans G.O. Bonds and the 2005 Revenue Bonds.

The Offered Veterans G.O. Bonds will be registered in the name of a nominee of The Depository Trust Company ("DTC") which will act as securities depository for the Offered Veterans G.O. Bonds. Beneficial interests in the Offered Veterans G.O. Bonds may be purchased in book-entry form only, in denominations of $5,000 or any integral multiple thereof. Principal and interest are payable as specified on the front cover page of this Official Statement. See APPENDIX C – "DTC AND THE BOOK-ENTRY SYSTEM."

Security for and Sources of Payment for Veterans G.O. Bonds

The Offered Veterans G.O. Bonds are general obligations of the State to which the full faith and credit of the State are pledged (see "AUTHORIZATION OF AND SECURITY FOR THE OFFERED VETERANS G.O. BONDS – Security for and Payment of Veterans G.O. Bonds" herein). Principal of and interest on all State general obligations bonds, including the Veterans G.O. Bonds, are payable from moneys in the General Fund of the State Treasury (the "General Fund"), subject only to the prior application of moneys in the General Fund to the support of the public school system and public institutions of higher education. See APPENDIX A – "THE STATE OF CALIFORNIA – STATE FINANCES – The General Fund." The Bond Acts authorizing the Offered Veterans G.O. Bonds provide that the State shall collect annually, in the same manner and at the same time as it collects other State revenues, a sum sufficient, in addition to the ordinary revenues of the State, to pay the principal of and interest on the Offered Veterans G.O. Bonds. State law requires funds for the payment of debt service on the Offered Veterans G.O. Bonds to be transferred to the General Fund from the Veterans Farm and Home Building Fund of 1943 (the "1943 Fund") under the circumstances described in the Bond Acts. See "AUTHORIZATION OF AND SECURITY FOR THE OFFERED VETERANS G.O. BONDS – SECURITY FOR AND PAYMENT OF VETERANS G.O. BONDS" and APPENDIX B – "THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND."

Redemption

The Offered Veterans G.O. Bonds are subject to optional and special redemption prior to maturity. In addition, (i) the Series CA Bonds and (ii) the Series CB Bonds maturing December 1, 2025 and December 1, 2036, respectively, are subject to mandatory redemption at par prior to their stated maturities, in part, from sinking fund payments made by the State. See "THE OFFERED VETERANS G.O. BONDS – Redemption."

Information Related to this Official Statement

The information set forth herein has been obtained from official sources which are believed to be reliable, but it is not guaranteed as to accuracy or completeness. The information and expressions of opinion herein are subject to change without notice, and neither delivery of this Official Statement nor any sale made hereunder or any future use of this Official Statement shall, under any circumstances, create any implication that there has been no change in the affairs of the State or the Department since the date hereof.

All financial and other information presented or incorporated by reference in this Official Statement has been provided by, respectively, the State or the Department from its records, *except* for information expressly attributed to other sources. The presentation of information, including tables of receipts from taxes and other revenues, is intended to show recent historic information and is not intended to indicate future or continuing trends in the financial position or other affairs of, respectively, the State or the Department. No representation is made that past experience, as it might be shown by such financial and other information, will necessarily continue or be repeated in the future. Any statements made in this Official Statement involving matters of opinion, projections or estimates, whether expressly stated or not, are set forth as such and not as representations of fact.

A wide variety of other information, including financial information, concerning the State is available from State agencies, State agency publications and State agency websites. Any such information that is inconsistent with the information set forth in this Official Statement should be disregarded. No such information is a part of or incorporated into this Official Statement, except as expressly noted. See "FINANCIAL STATEMENTS" AND APPENDIX A- "THE STATE OF CALIFORNIA – FINANCIAL STATEMENTS."

The information in APPENDIX C–"DTC AND THE BOOK-ENTRY SYSTEM" has been furnished by The Depository Trust Company and no representation is made by the State, the Underwriters, the Pricing Advisor or the purchasers of the Offered Veterans G.O. Bonds as to the accuracy or completeness of such information.

This Official Statement does not constitute an offer to sell or the solicitation of an offer to buy nor shall there be any sale of the Offered Veterans G.O. Bonds by any person in any jurisdiction in which it is unlawful for such person to make such an offer, solicitation or sale.

No dealer, broker, salesperson or other person has been authorized by the State to give any information or to make any representations other than those contained herein and, if given or made, such other information or representations must not be relied upon as having been authorized by the State. This Official Statement is not to be construed as a contract with the purchasers of the Offered Veterans G.O. Bonds.

IN CONNECTION WITH THE OFFERING OF THE OFFERED VETERANS G.O. BONDS THE UNDERWRITERS MAY OVER ALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICES OF THE OFFERED VETERANS G.O. BONDS OFFERED HEREBY AT LEVELS ABOVE THOSE WHICH

MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

Tax Matters

In the opinion of Hawkins Delafield & Wood LLP, Bond Counsel to the State, under existing statutes and court decisions, assuming continuing compliance by the State and the Department with certain tax covenants described therein, (i) interest on the Offered Veterans G.O. Bonds is excluded from gross income for Federal income tax purposes pursuant to Section 103 of the Internal Revenue Code of 1986, as amended (the "Federal Tax Code"), and such interest is exempt from personal income taxes of the State of California under present State law, (ii) interest on the Series CA Bonds is not treated as a preference item for purposes of calculating the alternative minimum tax imposed on individuals and corporations under the Federal Tax Code; such interest, *however,* is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations, and (iii) interest on the Series CB Bonds is treated as a preference item for purposes of calculating the alternative minimum tax imposed on individuals and corporations under the Federal Tax Code. See "TAX MATTERS" below, APPENDIX E – "CERTAIN FEDERAL TAX CODE REQUIREMENTS" and APPENDIX G – "LEGAL OPINION OF BOND COUNSEL TO THE STATE."

Continuing Disclosure

The Treasurer of the State of California (the "State Treasurer") will agree on behalf of the State to provide annually certain financial information and operating data relating to the State by not later than April 1 of each year in which any Offered Veterans G.O. Bonds are outstanding (the "Treasurer's Annual Report"), commencing with the report for the 2004-2005 Fiscal Year, and to provide notices of the occurrence of certain other enumerated events if material. The Secretary of the Department will agree to provide annually certain financial information and operating data relating to the Program by not later than April 1 of each year in which any Offered Veterans G.O. Bonds are outstanding (the "Department's Annual Report"). The specific nature of the information to be contained in the Treasurer's Annual Report and the Department's Annual Report or the notices of material events and certain other terms of the continuing disclosure obligations are summarized in APPENDIX D – "SUMMARY OF CONTINUING DISCLOSURE CERTIFICATES."

The State and the Department have not failed to comply, in all material respects, with any "previous undertakings," as that term is used in Rule 15c2-12 promulgated under the Securities Exchange Act of 1934, as amended.

Additional Information

Questions regarding this Official Statement and the issuance of these securities may be addressed to the office of the Honorable Philip Angelides, Treasurer of the State of California, P.O. Box 942809, Sacramento, California 94209-0001, telephone (800) 900-3873. Questions regarding the Program should be addressed to the Bond Finance Division of the Department of

Veterans Affairs, P.O. Box 942895, Sacramento, California 94295-0001, telephone (916) 653-2081.

AUTHORIZATION OF AND SECURITY FOR THE OFFERED VETERANS G.O. BONDS

Authorization

Each general obligation bond act authorizing the issuance of Veterans G.O. Bonds (each, a "Bond Act") incorporates by reference the State General Obligation Bond Law (the "Law"), which is set forth in Chapter 4 (commencing with Section 16720) of Part 3 of Division 4 of Title 2 of the California Government Code. The Law provides for the authorization, sale, issuance, use of proceeds, repayment and refunding of State general obligation bonds.

Currently, $605,585,000 of new issue Veterans G.O. Bonds are authorized under Bond Acts but not issued (not including the Offered Veterans G.O. Bonds). See APPENDIX B – "THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND – THE 1943 FUND – General."

Security for and Payment of Veterans G.O. Bonds

The Veterans G.O. Bonds are general obligations of the State, payable in accordance with the Bond Acts out of the General Fund. The full faith and credit of the State are pledged for the punctual payment of the principal of and the interest on the Veterans G.O. Bonds. All payments of principal, premium, if any, and interest on all State general obligation bonds, including the Offered Veterans G.O. Bonds, have an equal claim to the General Fund, subject only to the prior application of moneys in the General Fund to the support of the public school systems and public institutions of higher education. The Bond Acts provide that the State shall collect annually in the same manner and at the same time as it collects other State revenue an amount sufficient, in addition to the ordinary revenue of the State, to pay principal of and interest on the Veterans G.O. Bonds. The Bond Acts also contain a continuing appropriation from the General Fund of the sum annually necessary to pay the principal of and the interest on the Veterans G.O. Bonds as they become due and payable.

The Department's principal fund is the 1943 Fund described in APPENDIX B – "THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND – THE 1943 FUND." The Military and Veterans Code of the State (the "Veterans Code"), of which the Bond Acts are a part, requires that, with respect to Veterans G.O. Bonds other than those issued under the Veterans Bond Act of 2000 (the "2000 Bond Act"), on the dates when funds are to be remitted to bondowners for the payment of debt service on such Veterans G.O. Bonds in each fiscal year, there shall be transferred to the General Fund to pay the debt service on such Veterans G.O. Bonds all of the money in the 1943 Fund (but not in excess of the amount of debt service then due and payable). The 2000 Bond Act provides that on the dates when funds in the General Fund are remitted to bondowners for the payment of debt service on Veterans G.O. Bonds issued under the 2000 Bond Act, moneys shall be returned to the General Fund from the 1943 Fund in an amount equal to such debt service payment (to the extent sufficient moneys are available in the 1943 Fund). If the money so transferred on the remittance dates is less than the debt service then due and payable or the reimbursement, as applicable, the balance remaining unpaid is required by the Veterans Code to be transferred to the General Fund out of the 1943 Fund as soon as it shall become available, together with interest thereon from the remittance date until paid, at the same rate of interest as borne by the applicable Veterans G.O. Bonds, compounded semiannually.

The Veterans Code does not grant any lien on the 1943 Fund or the moneys therein to the holders of any Veterans G.O. Bonds. As of December 31, 2004, there were outstanding $1,270,685,000 aggregate principal amount of Veterans G.O. Bonds, not including the Offered Veterans G.O. Bonds. Outstanding Home Purchase Revenue Bonds in the aggregate principal amount of $575,845,000 (as of December 31, 2004, and not including the 2005 Revenue Bonds) previously issued by the Department (collectively with any additional Home Purchase Revenue Bonds issued by the Department in the future, the "Revenue Bonds") are and will be special obligations of the Department payable solely from, and secured by a pledge of, an undivided interest in the assets of the 1943 Fund (other than proceeds of Veterans G.O. Bonds or any amounts in any rebate account) and any reserve accounts established for the benefit of Revenue Bonds. The Veterans Code provides that this undivided interest in the 1943 Fund is secondary and subordinate to any interest or right in the assets of the 1943 Fund of the people of the State and of the holders of the Veterans G.O. Bonds (that is, the right to payment or reimbursements of debt service on Veterans G.O. Bonds described in the preceding paragraph). If debt service payments to the General Fund are current and all reimbursement of debt service payments with interest as described in the preceding paragraph has been made, no holder or beneficial owner of Veterans G.O. Bonds has any right to restrict disbursements by the Department from the 1943 Fund for any lawful purpose, including payment of debt service on or redemptions and purchases of Revenue Bonds.

For additional information, see APPENDIX B – "THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND – THE 1943 FUND" and EXHIBIT 1 to APPENDIX B – "FINANCIAL STATEMENTS OF THE 1943 FUND FOR FISCAL YEARS 2004 AND 2003 AND INDEPENDENT AUDITORS' REPORT."

THE OFFERED VETERANS G.O. BONDS

General

The Offered Veterans G.O. Bonds will be registered in the name of the nominee of DTC, which will act as securities depository for the Offered Veterans G.O. Bonds. Beneficial interests in the Offered Veterans G.O. Bonds may be purchased in book-entry form only, in denominations of $5,000 or any integral multiple thereof. See APPENDIX C – "DTC AND THE BOOK-ENTRY SYSTEM."

The Offered Veterans G.O. Bonds will be dated the Dated Date (as shown on the cover page hereof) and will mature on the respective dates and in the respective amounts set forth on the cover page hereof. Interest on the Offered Veterans G.O. Bonds will accrue from the Dated Date at the respective rates shown on the cover page of this Official Statement. Interest on the Offered Veterans G.O. Bonds is payable on June 1 and December 1 in each year (each, an

"Interest Payment Date") commencing December 1, 2005 and shall be calculated on the basis of a 360-day year comprised of twelve 30-day months.

Principal and interest are payable directly to DTC by the State Treasurer. Upon receipt of payments of principal and interest, DTC is to in turn remit such principal and interest to the participants in DTC for disbursement to the beneficial owners of the Offered Veterans G.O. Bonds. The record date for the payment of interest on the Offered Veterans G.O. Bonds is the close of business on the 15th day of the month immediately preceding an Interest Payment Date, whether or not the record date falls on a business day.

In reading this Official Statement it should be understood that while the Offered Veterans G.O. Bonds are in the Book-Entry-Only System, (i) all rights of ownership must be exercised through DTC and the Book-Entry-Only System, and (ii) notices that are to be given to registered owners by the State will be given only to DTC.

Purpose

Under the Program, the Department acquires residential property to be sold to eligible veterans under Contracts of Purchase between the Department and such veterans. Such acquisition is financed principally with the proceeds of Veterans G.O. Bonds and the Department's Revenue Bonds. The Offered Veterans G.O. Bonds are being issued for (i) reimbursing the Department for existing Contracts of Purchase previously funded by the 1943 Fund; and (ii) refunding certain outstanding Veterans G.O. Bonds and/or State commercial paper. See EXHIBIT 2 TO APPENDIX B – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Veterans G.O. Bonds and Revenue Bonds – Selected Information with Respect to Veterans G.O. Bonds and Revenue Bonds" for information about Veterans G.O. Bonds expected to be refunded and "– Contracts of Purchase – Amounts Expected to be Available to Fund Contracts of Purchase and Related Investments" for information regarding the amount of money expected to be made available to finance Contracts of Purchase upon the issuance of the Offered Veterans G.O. Bonds.

The Department expects to issue the 2005 Revenue Bonds on April 28, 2005. The 2005 Revenue Bonds are being issued to refund certain optionally redeemable Revenue Bonds, reduce the Department's cost of borrowing and/or to replace certain outstanding variable rate Revenue Bonds with fixed rate Revenue Bonds.

See EXHIBIT 2 to APPENDIX B – "DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND – Certain Department Financial Information and Operating Data – Contracts of Purchase – Amounts Expected to be Available to Fund Contracts of Purchase and Related Investments."

Identification and Authorization of the Offered Veterans G.O. Bonds

The Series CA Bonds are issued under one Bond Act and the Series CB Bonds are issued under five Bond Acts, authorized by the voters, as described below. See APPENDIX A – "THE STATE OF CALIFORNIA – STATE INDEBTEDNESS AND OTHER OBLIGATIONS."

Authorization

$16,000,000 principal amount of Veterans General Obligation Bonds, Series CA, authorized under the Veterans Bond Act of 1996.

$58,305,000 principal amount of Veterans General Obligation Bonds, Series CB, authorized under the Veterans Bond Act of 1986.

$39,980,000 principal amount of Veterans General Obligation Bonds, Series CB, authorized under the Veterans Bond Act of 1988.

$3,180,000 principal amount of Veterans General Obligation Bonds, Series CB, authorized under the Veterans Bond Act of 1990.

$89,595,000 principal amount of Veterans General Obligation Bonds, Series CB, authorized under the Veterans Bond Act of 1996.

$14,415,000 principal amount of Veterans General Obligation Bonds, Series CB, authorized under the Veterans Bond Act of 2000.

Redemption

Sinking Fund Redemption

The Series CB Bonds maturing on December 1, 2025 and December 1, 2036, respectively (the "Term Bonds"), are subject to redemption prior to their respective stated maturity dates, in part, by lot, from sinking fund payments, at a redemption price of 100 percent of the principal amount thereof, plus accrued interest to the date fixed for redemption, without premium, on the respective dates and in the respective amounts shown below.

SINKING FUND REDEMPTION SCHEDULE

December 1	CB Term Bonds Maturing December 1, 2025	CB Term Bonds Maturing December 1, 2036
2019	$ 750,000	
2020	750,000	
2021	750,000	
2022	750,000	
2023	4,000,000	
2024	9,000,000	
2025	10,000,000†	
2026		$ 8,000,000
2027		8,000,000
2028		8,000,000
2029		8,000,000
2030		8,000,000
2031		9,000,000
2032		9,000,000
2033		10,000,000
2034		10,000,000
2035		7,000,000
2036		9,000,000†

† Stated Maturity.

If less than all of the Term Bonds of the same series and maturity date are purchased or called for redemption (other than in satisfaction of sinking fund payments), the State Treasurer will credit the principal amount of such Term Bonds that are so purchased or redeemed against applicable remaining sinking fund payments relating to such Term Bonds (including the principal amounts due on the respective maturity dates, as shown above), as requested by the Department.

Optional Redemption

The Offered Veterans G.O. Bonds are subject to optional redemption prior to their respective stated maturity dates, at the option of the State upon request of the Department, in whole or in part (of any maturity and by lot within each maturity), on any date on or after June 1, 2015 from any moneys made available for such purpose, at a redemption price equal to 100% of the Offered Veterans G.O. Bonds to be redeemed, without premium plus accrued interest thereon to the redemption date.

Special Redemption from Excess Revenues

The Offered Veterans G.O. Bonds are subject to special redemption on any date prior to their respective stated maturity dates, at the option of the State upon request of the Department, from Excess Revenues (as defined below) derived from any Veterans G.O. Bonds or any Revenue Bonds. Any such redemption may be in whole or in part (and of any maturity of any Series at the option of the State upon request of the Department and by lot within such maturity), at the principal amount thereof plus accrued interest to the date fixed for redemption, without premium.

"Excess Revenues" means, as of any date of calculation, Revenues in excess of Accrued Debt Service. Excess Revenues can include prepayments and repayments on Contracts of Purchase funded by Revenue Bonds and Veterans G.O. Bonds, investment earnings, certain insurance receipts and also includes Revenues which had been set aside to be recycled into new Contracts of Purchase. All payments on Contracts of Purchase are deposited in the 1943 Fund and applied to pay or reimburse debt service on the Veterans G.O. Bonds, to pay debt service on Revenue Bonds, to pay for mandatory redemptions of Veterans G.O. Bonds and Revenue Bonds, to pay Program and Department expenses, and to pay certain insurance claims. The Department, subject to applicable bond authorizing resolutions, may apply Excess Revenues to redeem any Veterans G.O. Bonds or Revenue Bonds eligible for redemption. The Department's decision to apply Excess Revenues to redeem bonds, to finance new Contracts of Purchase, or for any other permitted purpose depends on many factors, including but not limited to applicable bond authorizing resolution requirements, demand for Contracts of Purchase, debt service cost savings, investment earnings, and Federal Tax Code requirements. A portion of the proceeds of the Offered Veterans G.O. Bonds will be used to reimburse the Department for its prior funding of existing Contracts of Purchase. Such amounts will be deposited to a Recycling Subaccount under the Revenue Bond Resolution. The Department presently plans to apply such funds to fund additional Contracts of Purchase. To the extent that such monies are not applied to the funding of additional Contracts of Purchase, as Revenues they will be applied in accordance with the Revenue Bond Resolution, including application as Excess Revenues. See EXHIBIT 2 to APPENDIX B – "CERTAIN DEPARTMENT FINANCIAL AND OPERATING DATA – AMOUNTS EXPECTED TO BE AVAILABLE TO FUND CONTRACTS OF PURCHASE AND RELATED INVESTMENTS." See APPENDIX B – "THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND – THE 1943 FUND – Excess Revenues."

Certain of the outstanding Veterans G.O. Bonds are not subject to redemption prior to maturity. However, the Offered Veterans G.O. Bonds are subject to such redemption. See EXHIBIT 2 to APPENDIX B – "THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND – CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA."

The Department's actual past prepayment experience for existing Contracts of Purchase is set forth in EXHIBIT 2 to APPENDIX B – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Contracts of Purchase Origination and Principal Repayment Experience."

For certain qualified mortgage bonds issued or to be issued after 1988, the Federal Tax Code prohibits repayments (including prepayments) of principal of Contracts of Purchase financed with the proceeds of an issue of such bonds to be used to make additional Contracts of Purchase after 10 years from the date of issuance of such bonds (or the date of issuance of original bonds in the case of refundings), after which date such amounts must be used to redeem such bonds of the issue, except for a $250,000 *de minimis* amount. See "TAX MATTERS – Federal Tax Matters."

The Federal Tax Code requires a payment to the United States from certain veterans whose Contracts of Purchase are originated after December 31, 1990 with the proceeds of qualified mortgage bonds. Since such requirement remains in effect with respect to any Contracts of Purchase originated after December 31, 1990 with proceeds of the applicable Revenue Bonds, for a period ending nine years after the execution of such Contracts of Purchase, the Department is unable to predict what effect, if any, such requirement will have on the origination or prepayment of Contracts of Purchase to which such provision applies.

Notice of Redemption

When redemption is required while the Offered Veterans G.O. Bonds are in book-entry form, the State Treasurer is to give notice of redemption by mailing copies of such notice only to DTC (not to the beneficial owners of the Offered Veterans G.O. Bonds) not less than thirty or more than sixty days prior to the date fixed for redemption. DTC, in turn, is to send the notice of redemption to its participants for distribution to the beneficial owners of the Offered Veterans G.O. Bonds. See APPENDIX C – "DTC AND THE BOOK-ENTRY SYSTEM." The notice will state, among other things, that the Offered Veterans G.O. Bonds or a designated portion thereof (in the case of partial redemption of an Offered Veterans G.O. Bond) are to be redeemed, the dated date of the Offered Veterans G.O. Bonds, the redemption date, the Series and maturities of the Offered Veterans G.O. Bonds to be redeemed and the redemption price. The notice will also state that after the date fixed for redemption, no further interest will accrue on the principal of any Offered Veterans G.O. Bonds called for redemption. Notice of redemption will also be provided by mail to certain financial information services and securities depositories.

TAX MATTERS

Federal Tax Matters

The Offered Veterans G.O. Bonds are considered a single issue for Federal income tax purposes with the 2005 Revenue Bonds. The requirements of applicable Federal tax law must be satisfied with respect to each series of the Offered Veterans G.O. Bonds and the 2005 Revenue Bonds in order that interest on the Offered Veterans G.O. Bonds not be included in gross income for Federal income tax purposes retroactive to the date of issuance thereof. Proceeds of the refunding portion of the Offered Veterans G.O. Bonds and the 2005 Revenue Bonds must be used to retire outstanding bonds within ninety days of their respective dates of issuance. Failure to so use all of such proceeds and to comply with other requirements of the Federal Tax Code with respect to either the Offered Veterans G.O. Bonds or the 2005 Revenue Bonds could cause interest on the Offered Veterans G.O. Bonds to be included in gross income for Federal income tax purposes retroactive to their date of issuance.

Requirements Imposed on the Offered Veterans G.O. Bonds and the 2005 Revenue Bonds by the Federal Tax Code

The Federal Tax Code contains the following loan eligibility requirements which are applicable (with certain exceptions), in whole or in part, to Contracts of Purchase (or portions of Contracts of Purchase) entered into with respect to properties acquired with amounts allocable to qualified veterans' mortgage bonds and/or to qualified mortgage bonds. The Offered Veterans G.O. Bonds are qualified veterans' mortgage bonds and not qualified mortgage bonds, and the 2005 Revenue Bonds are pre-Ullman bonds (as such terms are defined in APPENDIX E). The 2005 Revenue Bonds are treated for Federal income tax purposes as refunding certain existing pre-Ullman bonds issued to finance the Program. The moneys which will be made available from the issuance of the Offered Veterans G.O. Bonds to finance Contracts of Purchase will be Qualified Veterans Mortgage Bond Proceeds, while the moneys which will be made available from the issuance of the 2005 Revenue Bonds to finance Contracts of Purchase will be Unrestricted Moneys (as such terms are defined in APPENDIX B). The loan eligibility requirements described in APPENDIX E – "CERTAIN FEDERAL TAX CODE REQUIREMENTS" do not apply to Unrestricted Moneys. These requirements also do not apply to the Contracts of Purchase to be allocated to the 2005 Revenue Bonds for Federal income tax purposes following payment of the bonds being refunded by the 2005 Revenue Bonds, including any new Contracts of Purchase so allocated. The Federal Tax Code establishes other requirements described below which will apply to the 2005 Revenue Bonds.

The first general requirement of the Federal Tax Code which is applicable to qualified veterans' mortgage bonds is that the aggregate amount that may be issued must not exceed the volume limit based upon statutory formula. The Offered Veterans G.O. Bonds are in compliance with such requirement.

The Federal Tax Code requires that the effective interest rate on mortgage loans financed with the lendable proceeds of qualified mortgage bonds and qualified veterans' mortgage bonds (such as the Offered Veterans G.O. Bonds) may not exceed the yield on the issue by more than 1.125% (1.50% for pre-Ullman bonds such as the 2005 Revenue Bonds) (see "Yield Limitations and Rebate" in APPENDIX E) and that certain investment earnings on non-mortgage investments, calculated based upon the extent such investment earnings exceed the amount that would have been earned on such investments if the investments were invested at a yield equal to the yield on the issue, be rebated to the United States or to veterans. The Department has covenanted to comply with these requirements and has established procedures to determine the amount of excess earnings, if any, that must be rebated to the United States or to veterans. See APPENDIX B – "THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND – THE PROGRAM – Contracts of Purchase" for discussions of provisions of the Veterans Code which affect the Department's ability to establish and to change interest rates on Contracts of Purchase.

Opinion of Bond Counsel to the State

In the opinion of Bond Counsel to the State (expected to be delivered in substantially the form set forth with respect to the Offered Veterans G.O. Bonds in APPENDIX G), under existing statutes and court decisions and assuming continuing compliance with certain tax covenants described herein, (i) interest on the Offered Veterans G.O. Bonds is excluded from gross income for Federal income tax purposes pursuant to Section 103 of the Code, (ii) interest on the Series CA Bonds is not treated as a preference item for purposes of calculating the alternative minimum tax imposed on individuals and corporations under the Federal Tax Code; such interest, *however,* is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations, and (iii) interest on the Series CB Bonds is treated as a preference item for purposes of calculating the alternative minimum tax imposed on individuals and corporations under the Federal Tax Code.

In rendering the foregoing opinions, Bond Counsel to the State has assumed and continues to assume compliance by the State and the Department with and enforcement by the State and the Department of the documents authorizing the issuance of the Offered Veterans G.O. Bonds and the 2005 Revenue Bonds and the applicable Program Documents (as such term is defined in APPENDIX E). Bond Counsel to the State has expressed and expresses no opinion as to the exclusion from gross income of interest on any Offered Veterans G.O. Bonds subsequent to any date on which action is taken pursuant to the documents authorizing the issuance of the Offered Veterans G.O. Bonds, for which action such documents require a legal opinion to the effect that taking such action will not adversely affect such exclusion, unless such firm delivers an opinion as of such date to such effect.

In rendering its opinions, Bond Counsel to the State expresses no opinion regarding any other Federal or, except as stated below under "State Tax Matters," state tax consequences with respect to the Offered Veterans G.O. Bonds. Bond Counsel to the State renders its opinions under existing statutes and court decisions as of the issue date, and assumes no obligation to update its opinions after the issue date to reflect any future action, fact or circumstance, or change in law or interpretation, or otherwise. In rendering its opinions, Bond Counsel to the State expresses no opinion on the effect of any action taken after the date of the opinion or not taken in reliance upon an opinion of other counsel on the exclusion from gross income for Federal income tax purposes of interest on the Offered Veterans G.O. Bonds, or under state and local tax law.

Certain Collateral Federal Tax Consequences

The following is a brief discussion of certain Federal income tax matters with respect to the Offered Veterans G.O. Bonds under existing statutes. It does not purport to deal with all aspects of Federal taxation that may be relevant to a particular owner of an Offered Veterans G.O. Bond. Prospective investors, particularly those who may be subject to special rules, are advised to consult their own tax advisors regarding the Federal tax consequences of owning and disposing of the Offered Veterans G.O. Bonds.

As noted above, interest on the Series CB Bonds is, and interest on the Series CA Bonds is not, a preference item in determining the tax liability of individuals, corporations, and other taxpayers subject to the alternative minimum tax imposed by Section 55 of the Federal Tax Code. Interest on the Offered Veterans G.O. Bonds must also be taken into account in determining the tax liability of foreign corporations subject to the branch profits tax imposed by Section 884 of the Federal Tax Code.

Prospective Owners of Offered Veterans G.O. Bonds should be aware that the ownership of such obligations may result in collateral Federal income tax consequences to various categories of persons, such as corporations (including S corporations and certain foreign corporations), financial institutions, property and casualty insurance companies, individual recipients of Social Security or Railroad Retirement benefits, and individuals otherwise eligible for the earned income tax credit and to taxpayers deemed to have incurred or continued indebtedness to purchase or carry obligations the interest on which is not included in gross income for Federal income tax purposes.

Legislation affecting municipal bonds is frequently considered by the United States Congress. There can be no assurance that legislation enacted or proposed after the date of issuance of the Offered Veterans G.O. Bonds will not have an adverse effect on the tax-exempt status or market price of the Offered Veterans G.O. Bonds.

State Tax Matters

In the opinion of Bond Counsel to the State to be rendered with respect to the Offered Veterans G.O. Bonds on the date of delivery thereof, interest on the Offered Veterans G.O. Bonds is exempt from personal income taxes of the State of California under State law in effect on the date of such opinion. A complete copy of the proposed form of opinion to be rendered with respect to the Offered Veterans G.O. Bonds is contained in APPENDIX G.

LEGAL OPINIONS

The opinion of the Honorable Bill Lockyer, Attorney General of the State of California (the "Attorney General"), approving the validity of the Offered Veterans G.O. Bonds, will accompany the Offered Veterans G.O. Bonds deposited with DTC. The opinion of Bond Counsel to the State approving the validity of the Offered Veterans G.O. Bonds and addressing certain tax matters will also accompany the Offered Veterans G.O. Bonds deposited with DTC. The proposed forms of the legal opinions of the Attorney General and Bond Counsel to the State are set forth in APPENDIX F AND APPENDIX G, respectively.

Certain legal matters will be passed upon by Quateman & Zidell LLP, Disclosure Counsel to the State, and by Sidley Austin Brown & Wood LLP, Special Counsel to the State regarding APPENDIX A. Certain legal matters will be passed upon for the Underwriters by their counsel, Kutak Rock LLP.

The Attorney General, Bond Counsel to the State, Disclosure Counsel to the State, Special Counsel to the State and counsel to the Underwriters undertake no responsibility for the accuracy, completeness or fairness of this Official Statement.

LITIGATION

The Attorney General has advised that, to his knowledge, no litigation is now pending (with service of process on the State or the Department having been accomplished) or threatened seeking to restrain or enjoin the sale, issuance, execution or delivery of the Offered Veterans

G.O. Bonds or challenging the validity of the Offered Veterans G.O. Bonds or any proceedings or authority under which the Offered Veterans G.O. Bonds are being issued.

At any given time, including the present, there are numerous civil actions pending against the State (including, but not limited to, those discussed in APPENDIX A), that could, if determined adversely to the State, affect the State's expenditures and, in some cases, its revenues and cash flow. While there can be no assurances as to the ultimate outcome and fiscal impact of such litigation, the State believes that it is unlikely that the outcome of any such litigation could materially adversely effect the State's ability to pay principal of, and interest on the Offered Veterans G.O. Bonds when due. See APPENDIX A – "THE STATE OF CALIFORNIA – LITIGATION."

There may, from time to time, be litigation affecting the Department that does not directly relate to the Veterans G.O. Bonds, which may nonetheless relate to the 1943 Fund.

UNDERWRITING

The Offered Veterans G.O. Bonds are being purchased by the Underwriters listed on the cover page. The Underwriters have jointly and severally agreed to purchase the Offered Veterans G.O. Bonds for a purchase price of $221,475,000.00 plus accrued interest. In connection therewith the Department will pay a fee to the Underwriters of $1,544,805.25. The initial public offering prices of the Offered Veterans G.O. Bonds may be changed from time to time by the Underwriters.

The purchase contract relating to the Offered Veterans G.O. Bonds provides that (i) the Underwriters will purchase all of the Offered Veterans G.O. Bonds if any of the Offered Veterans G.O. Bonds are purchased, and (ii) the obligation to make such purchase is subject to certain terms and conditions set forth in such purchase contract including, among others, the approval of certain legal matters by counsel.

FINANCIAL STATEMENTS

Audited General Purpose Financial Statements of the State of California (the "Financial Statements") are available for the Fiscal Year ended June 30, 2004. Such Financial Statements have been filed with all of the Nationally Recognized Municipal Securities Information Repositories, as part of an Official Statement for certain State of California bonds sold previously this year, and are incorporated by reference into this Official Statement. The Financial Statements are also available through electronic means. No such information is a part of or incorporated into this Official Statement, except as expressly noted. SEE APPENDIX A – "THE STATE OF CALIFORNIA – FINANCIAL STATEMENTS" for further information on how to obtain or view the Financial Statements.

Certain unaudited financial information for the period ended March 31, 2005 is included as EXHIBIT 1 TO APPENDIX A. SEE APPENDIX A – EXHIBIT 1 – STATE CONTROLLER'S "STATEMENT OF GENERAL FUND CASH RECEIPTS AND DISBURSEMENTS, JULY 1, 2004 – MARCH 31, 2005 (UNAUDITED)."

INDEPENDENT AUDITORS

Attached as EXHIBIT 1 TO APPENDIX B are the Financial Statements for the Veterans Farm and Home Building Fund of 1943 for the years ended June 30, 2004 and 2003. These statements have been audited by Deloitte & Touche LLP, independent auditors, as indicated in their report appearing in APPENDIX B.

RATINGS

The Underwriters' obligation to purchase the Offered Veterans G.O. Bonds are conditioned upon the Offered Veterans G.O. Bonds receiving ratings of "A3" by Moody's, "AA-" by S&P, and "A" by Fitch. An explanation of the significance and status of such credit ratings may be obtained from the rating agencies furnishing the same. There is no assurance that such ratings will continue for any given period of time or that they will not be revised or withdrawn entirely by any such rating agencies if, in their respective judgments, circumstances so warrant.

ADDITIONAL INFORMATION

The purpose of this Official Statement is to supply information to prospective buyers of the Offered Veterans G.O. Bonds. Gardner, Underwood & Bacon LLC served as the Pricing Advisor to the State in connection with the issuance of the Offered Veterans G.O. Bonds.

The State Treasurer will execute a certificate upon delivery of the Offered Veterans G.O. Bonds to the effect that, to the best of the State Treasurer's knowledge and belief, as of the delivery date, the information and statements, including financial statements, of or pertaining to the State contained in this Official Statement relating to the Offered Veterans G.O. Bonds are true and correct in all material respects and does not and will not contain any untrue statement of a material fact or omit to state any material fact necessary to make the statements therein, in the light of the circumstances under which they were made, not misleading.

STATE OF CALIFORNIA
PHILIP ANGELIDES
Treasurer of the State of California

APPENDIX A

THE STATE OF CALIFORNIA

Honorable Philip Angelides
Treasurer of the State of California

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TABLE OF CONTENTS

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INTRODUCTION TO APPENDIX A

Importance of APPENDIX A. APPENDIX A is the part of the Official Statement that provides investors with information concerning the State of California (the "State"). Investors are advised to read the entire Official Statement, including APPENDIX A, to obtain information essential to making an informed investment decision.

Payment Priority of General Obligation Bonds. The Bonds are general obligations of the State to which the full faith and credit of the State are pledged. Principal of, premium, if any, and interest on all State general obligation bonds, including the Bonds, are payable from any moneys in the General Fund of the State, subject only to the prior application of such moneys to the support of the public school system and public institutions of higher education.

California's Credit History. California has always paid the principal of and interest on its general obligation bonds, general obligation commercial paper notes, lease-purchase obligations and short-term obligations, including revenue anticipation notes and revenue anticipation warrants, when due.

In July 2003, Standard & Poor's downgraded the State's general obligation credit rating to "BBB." In December 2003, the State's general obligation credit rating was downgraded to "BBB" by Fitch and "Baa1" by Moody's.

In May 2004, Moody's upgraded the State's general obligation bond rating to "A3" with a positive outlook. In August 2004, Standard & Poor's raised its rating on the State's general obligation bonds to "A" from "BBB" and removed the State's general obligation bonds from its credit watch. In September 2004, Fitch raised its rating on the State's general obligation bonds to "A–" from "BBB."

Any revisions or withdrawal of a credit rating could have an effect on the market price and liquidity of the Bonds. The State cannot predict the timing or impact of future actions by the rating agencies. See also "RATINGS" in the forepart of this Official Statement.

Overview of APPENDIX A. APPENDIX A begins with a description of recent developments regarding the State's economy and finances and then discusses the types of debt instruments that the State has issued and is authorized to issue in the future. See "RECENT DEVELOPMENTS REGARDING STATE ECONOMY AND FINANCES" and "STATE INDEBTEDNESS AND OTHER OBLIGATIONS." A discussion of the State's current and projected cash flow is contained under "STATE INDEBTEDNESS AND OTHER OBLIGATIONS — Cash Flow Borrowings."

APPENDIX A continues with a discussion of the sources and uses of State funds. See "STATE FINANCES." The budget process and constraints on this process, as well as the budget proposed by the Governor and the economic assumptions underlying the revenue projections contained in the proposed budget, are discussed under "THE BUDGET PROCESS" and "CURRENT STATE BUDGET AND GOVERNOR'S PROPOSED 2005–06 BUDGET."

Then, APPENDIX A includes or incorporates by reference the Audited Annual Financial Statements of the State for the Year Ended June 30, 2004, together with certain information required by governmental accounting and financial reporting standards to be included in the Financial Statements, including a "Management's Discussion and Analysis" that describes and analyzes the financial position of the State and provides an overview of the State's activities for the fiscal year ended June 30, 2004. The State Controller's unaudited report of cash receipts and disbursements for the period July 1, 2004 through March 31, 2005 is also included in this APPENDIX A. See "FINANCIAL STATEMENTS."

Governance, management and employee information is set forth under "OVERVIEW OF STATE GOVERNMENT." Demographic and economic statistical information is included under "ECONOMY AND POPULATION." APPENDIX A concludes with a description of material litigation involving the State (see "LITIGATION") and debt tables (see "STATE DEBT TABLES").

STATE INDEBTEDNESS AND OTHER OBLIGATIONS

General

The State Treasurer is responsible for the sale of debt obligations of the State and its various authorities and agencies. The State has always paid the principal of and interest on its general obligation bonds, general obligation commercial paper notes, lease-purchase debt and short-term obligations, including revenue anticipation notes and revenue anticipation warrants, when due. See the introduction to "STATE DEBT TABLES" for information as to indebtedness and other obligations incurred after April 1, 2005.

Capital Facilities Financing

General Obligation Bonds

The State Constitution prohibits the creation of general obligation indebtedness of the State unless a bond measure is approved by a majority of the electorate voting at a general election or a direct primary. General obligation bond acts provide that debt service on general obligation bonds shall be appropriated annually from the General Fund and all debt service on general obligation bonds is paid from the General Fund. Under the State Constitution, debt service on general obligation bonds is the second charge to the General Fund after the application of moneys in the General Fund to the support of the public school system and public institutions of higher education. See "STATE FINANCES — State Expenditures." Certain general obligation bond programs receive revenues from sources other than the sale of bonds or the investment of bond proceeds.

As of April 1, 2005, the State had outstanding $47,130,747,000 aggregate principal amount of long-term general obligation bonds, and unused voter authorizations for the future issuance of $35,860,521,000 of long-term general obligation bonds. This latter figure consists of $19,448,319,000 of general obligation bonds which are authorized by State finance committees to be issued initially as commercial paper notes, described below, and $16,412,202,000 of other authorized but unissued general obligation bonds. These outstanding and authorized amounts include the economic recovery bonds. See "— Economic Recovery Bonds" below. See also the table "Authorized and Outstanding General Obligation Bonds" under "STATE DEBT TABLES."

General obligation bond law permits the State to issue as variable rate indebtedness up to 20 percent of the aggregate amount of long-term general obligation bonds outstanding. The State has issued $6,374,565,000 variable rate general obligation bonds (which includes the economic recovery bonds), representing 13.5 percent of the State's total outstanding general obligation bonds as of April 1, 2005.

Initiative measures to issue $3 billion in bonds (California Stem Cell Research and Cures Act) and to issue $750 million in bonds (Children's Hospital Projects Bond Act) were approved by the voters in the November 2004 election.

The Legislature has approved approximately $600 million of new bond authorization, the California Reading and Literacy Improvement and Public Library Construction and Renovation Bond Act of 2006, to be placed on the June 2006 primary election ballot. A $9.95 billion bond measure for high speed rail projects has been placed on the November 2006 general election ballot. Additional bond proposals may also be added to the 2006 primary or general election ballots.

Commercial Paper Program

Pursuant to legislation enacted in 1995, voter-approved general obligation indebtedness may be issued either as long-term bonds or, for some but not all bond issues, as commercial paper notes. Commercial paper notes may be renewed or may be refunded by the issuance of long-term bonds. The State issues long-term general obligation bonds from time to time to retire its general obligation commercial paper notes. Commercial paper notes are deemed issued upon authorization by the respective finance committees, whether or not such notes are actually issued. Pursuant to the terms of the bank credit agreement presently in effect, the general obligation commercial paper program may have up to \$1.5 billion in aggregate principal and interest commitments outstanding at any time. This amount may be increased or decreased in the future. As of April 1, 2005, the finance committees had authorized the issuance of up to \$19,448,319,000 of commercial paper notes and, as of that date, \$70,780,000 aggregate principal amount of general obligation commercial paper notes were outstanding. See "STATE DEBT TABLES" for information on the current outstanding amount of commercial paper notes.

Lease-Purchase Obligations

In addition to general obligation bonds, the State builds and acquires capital facilities through the use of lease-purchase borrowing. Under these arrangements, the State Public Works Board, another State or local agency or a joint powers authority issues bonds to pay for the construction of facilities such as office buildings, university buildings or correctional institutions. These facilities are leased to a State agency or the University of California under a long-term lease that provides the source of payment of the debt service on the lease-purchase bonds. In some cases, there is not a separate bond issue, but a trustee directly creates certificates of participation in the State's lease obligation, which are then marketed to investors. Under applicable court decisions, such lease arrangements do not constitute the creation of "indebtedness" within the meaning of the State Constitutional provisions that require voter approval. For purposes of this Appendix A and the tables under "STATE DEBT TABLES," "lease-purchase obligation" or "lease-purchase financing" means principally bonds or certificates of participation for capital facilities where the rental payments providing the security are a direct or indirect charge against the General Fund and also includes revenue bonds for a State energy efficiency program secured by payments made by various State agencies under energy service contracts. Certain of the lease-purchase financings are supported by special funds rather than the General Fund. See "STATE FINANCES — Sources of Tax Revenue — Special Fund Revenues." The tables under "STATE DEBT TABLES" do not include equipment leases or leases which were not sold, directly or indirectly, to the public capital markets. The State had \$7,158,477,629 General Fund-supported lease-purchase obligations outstanding as of April 1, 2005. The State Public Works Board, which is authorized to sell lease revenue bonds, had \$3,810,293,000 authorized and unissued as of April 1, 2005. In addition, as of that date, certain joint powers authorities were authorized to issue approximately \$81,000,000 of revenue bonds to be secured by State leases.

Non-Recourse Debt

Certain State agencies and authorities issue revenue obligations for which the General Fund has no liability. Revenue bonds represent obligations payable from State revenue-producing enterprises and projects, which are not payable from the General Fund, and conduit obligations payable only from revenues paid by private users of facilities financed by the revenue bonds. The enterprises and projects include transportation projects, various public works projects, public and private educational facilities (including the California State University and University of California systems), housing, health facilities and pollution control facilities. State agencies and authorities had $41,494,910,795 aggregate principal amount of revenue bonds and notes which are non–recourse to the General Fund outstanding as of December 31, 2004, as further described in the table "State Agency Revenue Bonds and Conduit Financing" under "STATE DEBT TABLES."

Detailed information regarding the State's long-term debt appears in the section "STATE DEBT TABLES."

Pension Obligation Bonds

The 2005-06 Governor's Budget assumed the issuance of $800 million of pension obligation bonds, yielding a net benefit to the General Fund of $765 million to make fiscal year 2005–06 contributions to the California Public Employees' Retirement System ("CalPERS"). The payment of the debt service on the pension obligation bonds will be payable from the General Fund. As with previous proposed pension bond issuances (as described below), the proposed pension obligation bonds will be the subject of a validation action brought by the Pension Obligation Bond Committee for and on behalf of the State. The Administration anticipates that bonds will be issued pursuant to the California Pension Restructuring Bond Act of 2004, Government Code Section 16940, et seq. (the "Restructuring Bond Act"), on or before April 1, 2006, and that the proceeds of such bonds will be available to fund the April and a portion of the June 2006 payments of the State's fiscal year 2005–06.

Pursuant to the Restructuring Bond Act, the Committee authorized the issuance of bonds to pay a portion of the State's pension obligation for fiscal year 2004–05. The Committee initiated a validation action seeking court determination that the bonds will not be in violation of the Constitutional debt limit because the proceeds of the bonds will be used to pay the State's employer contribution obligation to CalPERS, which is an "obligation imposed by law." The validation action was challenged in the court by the Pacific Legal Foundation. This legal challenge would have made it impossible to reach resolution through the court in time to issue the bonds by April 1, 2005, to pay 2004–05 pension obligations. Therefore, the State is not expecting to issue pension obligation bonds for the 2004–05 fiscal year. The issuance of 2005–06 pension obligation bonds is also subject to this challenge. There can be no assurance that the validation action will be successful. See "LITIGATION — Matter Seeking Validation of Pension Obligation Bonds."

The Restructuring Bond Act limits the maximum amount of bonds that can be issued to no more than one-third of the 20 years savings expected to result from restructuring the State's pension programs, estimated at $800 million. Chapter 215, Statutes 2004, includes reforms to the State's pension obligations, which the Administration estimates will reduce pension costs in a cumulative amount of $2.4 billion over the next 20 years. These reforms place all new hires to the State in miscellaneous and industrial retirement categories (approximately 70% of all new hires) into an alternate retirement program whereby they contribute to a defined contribution pension for the first two years of state service. During this time, the State makes no contributions to CalPERS on their behalf.

Economic Recovery Bonds

The California Economic Recovery Bond Act ("Proposition 57") was approved by the voters at the statewide primary election on March 2, 2004. Proposition 57 authorizes the issuance of up to $15 billion in economic recovery bonds to finance the negative General Fund reserve balance as of June 30, 2004, and other General Fund obligations undertaken prior to June 30, 2004. Repayment of the economic recovery bonds is secured by a pledge of revenues from a one-quarter cent increase in the State's sales and use tax starting July 1, 2004. Fifty percent of each annual deposit, or up to $5 billion in the aggregate of future deposits in the reserve fund created by the Balanced Budget Amendment

("Proposition 58"), is to be used to repay the economic recovery bonds. In addition, as voter-approved general obligation bonds, the economic recovery bonds are secured by the State's full faith and credit. However, moneys in the General Fund will only be used in the event the dedicated sales and use tax revenue is insufficient to repay the bonds.

The State has issued $10.896 billion principal amount of economic recovery bonds, resulting in the deposit of net proceeds to the General Fund of approximately $11.254 billion during the 2003–04 fiscal year (of which, for budgetary purposes, approximately $9.2 billion was applied to the 2002–03 fiscal year and approximately $2 billion has been applied to offset fiscal year 2004–05 General Fund expenditures). The 2005–06 Governor's Budget proposes the issuance of $1.683 billion of economic recovery bonds for funding fiscal year 2005–06 budget requirements. The State may issue the remainder of authorized economic recovery bonds in the current or future fiscal years. See "CURRENT STATE BUDGET AND GOVERNOR'S PROPOSED 2005–06 BUDGET — 2004 Budget Act."

Tobacco Settlement Revenue Bonds

In 1998 the State signed a settlement agreement with the four major cigarette manufacturers. Under the settlement agreement, the cigarette manufacturers agreed to make payments to the State in perpetuity, which payments amount to approximately $25 billion (subject to adjustments) over the first 25 years. Under a separate Memorandum of Understanding, half of the payments made by the cigarette manufacturers will be paid to the State and half to local governments (all counties and the cities of San Diego, Los Angeles, San Francisco and San Jose). The specific amount to be received by the State and local governments is subject to adjustment. Details in the settlement agreement allow reduction of the manufacturers' payments for decreases in cigarette shipment volumes by the settling manufacturers, payments owed to certain "Previously Settled States" and certain types of offsets for disputed payments, among other things. However, settlement payments are adjusted upward each year by at least 3 percent for inflation, compounded annually.

Chapter 414, Statutes of 2002, enacted Government Code Sections 63049 to 63049.5 (the "Tobacco Securitization Law"), which authorized the issuance of revenue bonds secured by the tobacco settlement revenues received by the State beginning in the 2003–04 fiscal year. An initial sale of 56.57 percent of the State's tobacco settlement revenues producing $2.5 billion in proceeds was completed in January 2003.

A second sale of the remaining 43.43 percent of the State's tobacco settlement revenues, which produced $2.264 billion in proceeds, was completed in September 2003. Chapter 225, Statutes of 2003, amended the Tobacco Securitization Law to require the Governor to request an appropriation in the annual Budget Act to pay debt service and other related costs of the tobacco settlement revenue bonds secured by the second (and only the second) sale of tobacco settlement revenues when such tobacco settlement revenues are insufficient therefor. The Legislature is not obligated to make any such requested appropriation.

Tobacco settlement revenue bonds are neither general nor legal obligations of the State or any of its political subdivisions and neither the faith and credit nor the taxing power nor any other assets or revenues of the State or of any political subdivision is or shall be pledged to the payment of any such bonds.

Cash Flow Borrowings

As part of its cash management program, the State has regularly issued short-term obligations to meet cash flow needs. The State has issued revenue anticipation notes ("Notes" or "RANs") in 19 of the last 20 fiscal years to partially fund timing differences between receipts and disbursements, as the majority of General Fund revenues are received in the last part of the fiscal year. By law, RANs must mature prior to the end of the fiscal year of issuance. If additional external cash flow borrowings are required, the State has issued revenue anticipation warrants ("RAWs"), which can mature in a subsequent fiscal year. See "STATE FINANCES — State Warrants." RANs and RAWs are both payable from any "Unapplied Money" in the General Fund of the State on their maturity date, subject to the prior application of such money in the General Fund to pay Priority Payments. "Priority Payments" are payments as and when due to: (i) support the public school system and public institutions of higher education (as provided in Section 8 of Article XVI of the Constitution of the State), (ii) pay principal of and interest on general obligation bonds and general obligation commercial paper notes of the State, (iii) provide reimbursement from the General Fund to any special fund or account to the extent such reimbursement is legally required to be made to repay borrowings therefrom pursuant to California Government Code Sections 16310 or 16418; and (iv) pay State employees' wages and benefits, State payments to pension and other State employee benefit trust funds, State Medi-Cal claims, and any amounts determined by a court of competent jurisdiction to be required to be paid with State warrants that can be cashed immediately. See "STATE FINANCES" below.

The following table shows the amount of RANs and RAWs issued in the past five fiscal years and the current fiscal year.

TABLE 1
State of California Revenue Anticipation Notes and Warrants Issued
Fiscal Years 1999–00 to 2004–05

Fiscal Year	Type	Principal Amount (Billions)	Date of Issue	Maturity Date
1999–00	Notes Series A-B	$1.00	October 1, 1999	June 30, 2000
2000–01	No Notes issued			
2001–02	Notes Series A-C	5.70	October 4, 2001	June 28, 2002
	RAWs Series A	1.50	June 24, 2002	October 25, 2002
	RAWs Series B	3.00	June 24, 2002	November 27, 2002
	RAWs Series C	3.00	June 24, 2002	January 30, 2003†
2002–03	Notes Series A and C	6.00	October 16, 2002	June 20, 2003
	Notes Series B and D	3.00	October 16, 2002	June 27, 2003
	Notes Series E – G	3.50	November 6, 2002	June 20, 2003
	RAWs Series A and B	10.965	June 18, 2003	June 16, 2004
2003–04	Notes	3.00	October 28, 2003	June 23, 2004
2004–05	Notes Series A – D	6.00	October 6, 2004	June 30, 2005

† Called by the Controller and paid on November 27, 2002.

Source: State of California, Office of the Treasurer.

STATE FINANCES

The General Fund

The moneys of the State are segregated into the General Fund and over 900 other funds, including special, bond and trust funds. The General Fund consists of revenues received by the State Treasury and not required by law to be credited to any other fund, as well as earnings from the investment of State moneys not allocable to another fund. The General Fund is the principal operating fund for the majority of governmental activities and is the depository of most of the major revenue sources of the State. For additional financial data relating to the General Fund, see the financial statements incorporated in or attached to this APPENDIX A. See "FINANCIAL STATEMENTS." The General Fund may be expended as a consequence of appropriation measures enacted by the Legislature and approved by the Governor (including the annual Budget Act), as well as appropriations pursuant to various constitutional authorizations and initiative statutes.

The Special Fund for Economic Uncertainties

The Special Fund for Economic Uncertainties ("SFEU") is funded with General Fund revenues and was established to protect the State from unforeseen revenue reductions and/or unanticipated expenditure increases. The State Controller may transfer amounts in the SFEU to the General Fund as necessary to meet cash needs of the General Fund and such transfers are characterized as "loans." The State Controller is required to return moneys so transferred without payment of interest as soon as there are sufficient moneys in the General Fund. At the end of each fiscal year, the Controller is required to transfer from the SFEU to the General Fund any amount necessary to eliminate any deficit in the General Fund.

The legislation creating the SFEU (Government Code Section 16418) contains a continuous appropriation from the General Fund authorizing the State Controller to transfer to the SFEU, as of the end of each fiscal year, the lesser of (i) the unencumbered balance in the General Fund and (ii) the difference between the State's "appropriations subject to limitation" for the fiscal year then ended and its "appropriations limit" as defined in Section 8 of Article XIII B of the State Constitution and established in the Budget Act for that fiscal year, as jointly estimated by the State Legislative Analyst's Office (the "LAO") and the Department of Finance. For a further description of Article XIII B, see "State Appropriations Limit." In certain circumstances, moneys in the SFEU may be used in connection with disaster relief.

For budgeting and accounting purposes, any appropriation made from the SFEU is deemed an appropriation from the General Fund. For year-end reporting purposes, the State Controller is required to add the balance in the SFEU to the balance in the General Fund so as to show the total moneys then available for General Fund purposes.

See Table 2 entitled "Internal Borrowable Resources (Cash Basis)" for information concerning the recent balances in the SFEU and projections of the balances for the current and upcoming fiscal years. As in any year, the Budget Act and related trailer bills are not the only pieces of legislation which appropriate funds. Other factors, including re-estimates of revenues and expenditures, existing statutory requirements and additional legislation introduced and passed by the Legislature may impact the fiscal year-end balance in the SFEU.

Inter-Fund Borrowings

Inter-fund borrowing is used to meet temporary imbalances of receipts and disbursements in the General Fund. In the event the General Fund is or will be exhausted, the State Controller is required to notify the Governor and the Pooled Money Investment Board (the "PMIB," comprised of the State Director of Finance, the State Treasurer and the State Controller). The Governor may then order the State Controller to direct the transfer of all or any part of the moneys not needed in special funds to the General Fund, as determined by the PMIB. All money so transferred must be returned to the special fund from which it was transferred as soon as there is sufficient money in the General Fund to do so. Transfers cannot be made which will interfere with the objective for which such special fund was created, or from certain specific funds. When moneys transferred to the General Fund in any fiscal year from any special fund pursuant to the inter-fund borrowing mechanism exceed ten percent of the total additions to such special fund as shown in the statement of operations of the preceding fiscal year as set forth in the Budgetary (Legal Basis) annual report of the State Controller, interest must be paid on such excess at a rate determined by the PMIB to be the current earning rate of the Pooled Money Investment Account.

As of March 31, 2005, $3.03 billion of outstanding loans from the SFEU and other internal sources were used to pay expenditures of the General Fund. See "STATE FINANCES — State Warrants" and EXHIBIT 1 — "STATE CONTROLLER'S STATEMENT OF GENERAL FUND CASH RECEIPTS AND DISBURSEMENTS, JULY 1, 2004 THROUGH MARCH 31, 2005 (UNAUDITED)."

Any determination of whether a proposed borrowing from one of the special funds is permissible must be made with regard to the facts and circumstances existing at the time of the proposed borrowing. The Attorney General of the State has identified certain criteria relevant to such a determination. For instance, amounts in the special funds eligible for inter-fund borrowings are legally available to be transferred to the General Fund if a reasonable estimate of expected General Fund revenues, based upon legislation already enacted, indicates that such transfers can be paid from the General Fund promptly if needed by the special funds or within a short period of time if not needed. In determining whether this requirement has been met, the Attorney General has stated that consideration may be given to the fact that General Fund revenues are projected to exceed expenditures entitled to a higher priority than payment of internal transfers, i.e., expenditures for the support of the public school system and public institutions of higher education and the payment of debt service on general obligation bonds of the State.

At the November 1998 election, voters approved Proposition 2. This proposition requires the General Fund to repay loans made from certain transportation special accounts (such as the State Highway Account) at least once per fiscal year, or up to 30 days after adoption of the annual Budget Act. Since the General Fund may reborrow from the transportation accounts any time after the annual repayment is made, the proposition does not have any adverse impact on the State's cash flow.

In addition to temporary inter-fund borrowings described in this section, budgets enacted in the current and past fiscal years have included other transfers and long-term loans from special funds to the General Fund. In some cases, such loans and transfers have the effect of reducing internal borrowable resources. As part of his budget reforms, the Governor has proposed that budgetary borrowing from special funds to cover General Fund shortfalls be prohibited in the future. See "THE BUDGET PROCESS — Governor's Budget Reform Proposals" and "CURRENT STATE BUDGET AND GOVERNOR'S PROPOSED 2005–06 BUDGET — Governor's Budget Reform Proposals and Related Initiative."

The following chart shows internal borrowable resources available for temporary loans to the General Fund on June 30 of each of the fiscal years 2001–02 through 2003–04 and estimates, as of January 10, 2005, for fiscal years 2004–05 and 2005–06. See also EXHIBIT 1 — "STATE

CONTROLLER'S STATEMENT OF GENERAL FUND CASH RECEIPTS AND DISBURSEMENTS, JULY 1, 2004 THROUGH MARCH 31, 2005 (UNAUDITED)."

TABLE 2
Internal Borrowable Resources
(Cash Basis)
(Millions)

	June 30				
	2002[(a)]	**2003[(b)]**	**2004[(c)]**	**2005[(d)]**	**2006[(d)]**
Available Internal Borrowable Resources	$12,979.7	$10,401.5	$9,951.3	$7,989.8	$7,801.1
Outstanding Loans					
From Special Fund for Economic Uncertainties	2,524.5	-0-	-0-	768.0	500.0
From Special Funds and Accounts	423.5	-0-	-0-	1,793.2	2,689.5
Total Outstanding Internal Loans	2,948.0	-0-	-0-	2,561.2	3,189.5
Unused Internal Borrowable Resources	$10,031.7	$10,401.5	$9,951.3	$5,428.6	$4,611.5

(a) At June 30, 2002, the State also had $7.5 billion of outstanding external borrowings in the form of revenue anticipation warrants.

(b) At June 30, 2003, the State also had $10.965 billion of outstanding external borrowings in the form of revenue anticipation warrants.

(c) Includes the receipt of $11.254 billion of economic recovery bond proceeds to the General Fund resulting from the issuance of three series of economic recovery bonds.

(d) Department of Finance estimates as of January 10, 2005.

Source: State of California, Department of Finance. Information for the fiscal years ended June 30, 2002 through June 30, 2004, are actual figures. Figures for the fiscal years ending June 30, 2005 and June 30, 2006 were estimated as of January 10, 2005 by the Department of Finance.

State Warrants

No money may be drawn from the State Treasury except upon a warrant duly issued by the State Controller. The State Controller is obligated to draw every warrant on the fund out of which it is payable for the payment of money directed by State law to be paid out of the State Treasury; however, a warrant may not be drawn unless authorized by law and unless unexhausted specific appropriations provided by law are available to meet it. State law provides two methods for the State Controller to respond if the General Fund has insufficient "Unapplied Money" available to pay a warrant when it is drawn, referred to generally as "registered warrants" and "reimbursement warrants." "Unapplied Money" consists of money in the General Fund for which outstanding warrants have not already been drawn and which would remain in the General Fund if all outstanding warrants previously drawn and then due were paid subject to the prior application of such money to obligations of the State with a higher priority. See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS — Cash Flow Borrowings." Unapplied Money may include moneys transferred to the General Fund from the SFEU and internal borrowings from State special funds (to the extent permitted by law). See "STATE FINANCES — The Special Fund for Economic Uncertainties" and "— Inter-Fund Borrowings."

Registered Warrants

If a warrant is drawn on the General Fund for an amount in excess of the amount of Unapplied Money in the General Fund, after deducting from such Unapplied Money the amount, as estimated by the State Controller, required by law to be set apart for obligations having priority over obligations to which such warrant is applicable, the warrant must be registered by the State Treasurer on the reverse side as not paid because of the shortage of funds in the General Fund. The State Controller then delivers such a "registered warrant" to persons or entities (e.g., suppliers and local governments) otherwise entitled to receive payments from the State. A registered warrant bears interest at a rate designated by the PMIB up to a maximum of five percent per annum or at a higher rate if issued for an unpaid revenue anticipation note or in connection with some form of credit enhancement. Registered warrants may or may not have a fixed maturity date. Registered warrants that have no fixed maturity date, and registered warrants that bear a maturity date but, for lack of Unapplied Moneys, were not paid at maturity, are paid, together with all interest due, when the Controller, with the approval of the PMIB, determines payment will be made. The State Controller then notifies the State Treasurer, who publishes a notice that the registered warrants in question are payable. The duties of the Controller and the PMIB are ministerial in nature, and the Controller and the PMIB may not legally refuse to pay the principal of or interest on any registered warrants on any date Unapplied Moneys are available in the General Fund after all Priority Payments have been made on that date.

Reimbursement Warrants

In lieu of issuing individual registered warrants to numerous creditors, State law provides an alternative procedure whereby the Governor, upon request of the Controller, may authorize utilizing the General Cash Revolving Fund in the State Treasury to borrow from other State special funds to meet payments authorized by law. The Controller may then issue "reimbursement warrants" in the financial market at competitive bid to reimburse the General Cash Revolving Fund, thereby increasing cash resources for the General Fund to cover required payments. The General Cash Revolving Fund exists solely to facilitate the issuance of reimbursement warrants. Reimbursement warrants may have a fixed maturity date.

The principal of and interest on reimbursement warrants must be paid by the Treasurer on their respective maturity dates from any Unapplied Money in the General Fund and available for such payment. In the event that Unapplied Money is not available for payment on the respective maturity dates of reimbursement warrants, and refunding warrants (see "— Refunding Warrants") have not been sold at such times as necessary to pay such reimbursement warrants, such reimbursement warrants will be paid, together with all interest due thereon (including interest accrued at the original interest rate after the maturity date), at such times as the Controller, with the approval of the PMIB, may determine.

The State issued reimbursement warrants on several occasions in order to meet its cash needs during the period 1992-1994, when State revenues were severely reduced because of an economic recession. Facing renewed economic pressures, the State issued reimbursement warrants in June 2002 and in June 2003. See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS — Cash Flow Borrowings."

Refunding Warrants

If there is not sufficient Unapplied Money in the General Fund to pay maturing reimbursement warrants, the Controller is authorized under State law, with the written approval of the Treasurer, to offer and sell a new issue of reimbursement warrants as refunding warrants to refund the prior, maturing reimbursement warrants. Proceeds of such refunding warrants must be used exclusively to repay the maturing warrants. In all other respects, refunding warrants have the same legal status and provisions as reimbursement warrants, as described above.

Sources of Tax Revenue

The following is a summary of the State's major revenue sources. The 2005–06 Governor's Budget estimates that General Fund tax revenues have increased by 8.7% in fiscal year 2004–05 and are projected to increase by 7% in fiscal year 2005-06. The relatively strong growth rates reflect sharp gains in corporate taxes and more moderate growth in sales and personal income taxes. Further information on State revenues is contained under "CURRENT STATE BUDGET AND GOVERNOR'S PROPOSED 2005–06 BUDGET" and "STATE FINANCES — Recent Tax Receipts." See Table 4 entitled "COMPARATIVE YIELD OF STATE TAXES — ALL FUNDS, 2000–01 THROUGH 2005–06" for a comparison, by amount received, of the sources of the State's tax revenue.

Personal Income Tax

The California personal income tax, which accounts for a significant portion of General Fund tax revenues, is closely modeled after the federal income tax law. It is imposed on net taxable income (gross income less exclusions and deductions), with rates ranging from 1.0 percent to 9.3 percent. The personal income tax is adjusted annually by the change in the consumer price index to prevent taxpayers from being pushed into higher tax brackets without a real increase in income. Personal, dependent and other credits are allowed against the gross tax liability. In addition, taxpayers may be subject to an alternative minimum tax ("AMT"), which is much like the federal AMT. The personal income tax structure is considered to be highly progressive. For example, the State Franchise Tax Board indicates that the top 1 percent of taxpayers paid 36.7 percent of the total personal income tax in tax year 2002.

Proposition 63, approved by the voters in the November 2004 election, imposes a 1 percent surcharge on taxpayers with taxable income over $1 million. The proceeds of the tax surcharge are required to be used to expand county mental health programs.

Taxes on capital gains realizations and stock options, which are largely linked to stock market performance, can add a significant dimension of volatility to personal income tax receipts. Capital gains and stock option tax receipts have accounted for as much as 24.7 percent and as little as 5.6 percent of General Fund revenues in the last ten years. See "CURRENT STATE BUDGET AND GOVERNOR'S PROPOSED 2005–06 BUDGET — Economic Assumptions."

Sales Tax

The sales tax is imposed upon retailers for the privilege of selling tangible personal property in California. Most retail sales and leases are subject to the tax. However, exemptions have been provided for certain essentials such as food for home consumption, prescription drugs, gas delivered through mains and electricity. Other exemptions provide relief for a variety of sales ranging from custom computer software to aircraft.

As of January 1, 2005, the breakdown of the base state and local sales tax rate of 7.25 percent is as follows:

- 5 percent imposed as a State General Fund tax;
- 0.5 percent dedicated to local governments for health and welfare program realignment (Local Revenue Fund);
- 0.5 percent dedicated to local governments for public safety services (Local Public Safety Fund);

- 1 percent local tax imposed under the Uniform Local Sales and Use Tax Law, with 0.25 percent dedicated to county transportation purposes and 0.75 percent for city and county general-purpose use (See below for a discussion of a court action seeking to prohibit the State Board of Equalization from implementing a one-quarter cent reduction in the local government sales and use tax, which was enacted at the time of the authorization of the State economic recovery bonds); and

- 0.25 percent deposited into the Fiscal Recovery Fund to repay the State's economic recovery bonds (the "Special Sales Tax").

Existing law provides that 0.25 percent of the basic 5 percent State tax rate may be suspended in any calendar year upon certification by the Director of Finance by November 1 in any year in which both of the following occur: (1) the General Fund reserve (excluding the revenues derived from the 0.25 percent sales and use tax rate) is expected to exceed 3 percent of revenues in that fiscal year (excluding the revenues derived from the 0.25 percent sales and use tax rate) and (2) actual revenues for the period May 1 through September 30 equal or exceed the May Revision forecast. The 0.25 percent rate will be reinstated the following year if the Director of Finance subsequently determines conditions (1) or (2) above are not met for that fiscal year. The 2005–06 Governor's Budget estimates that the reserve level will be insufficient to trigger a reduction for calendar year 2006. See "CURRENT STATE BUDGET AND GOVERNOR'S PROPOSED 2005–06 BUDGET — Summary of State Revenues and Expenditures" for a projection of the fiscal year 2004–05 General Fund reserve.

Existing law provides that the Special Sales Tax will be collected until the first day of the calendar quarter at least 90 days after the Director of Finance certifies that all economic recovery bonds and related obligations have been paid or retired or provision for their repayment has been made or enough sales taxes have been collected to pay all economic recovery bonds and related obligations to final maturity. At such time the Special Sales Tax will terminate and the city and county portion of taxes under the Uniform Local Sales and Use Tax will be automatically increased by 0.25 percent.

Senate Constitutional Amendment No. 4, approved by the voters as Proposition 1A in the November 2004 election, amended the State Constitution to, among other things, reduce the Legislature's authority over local government revenue sources by restricting the State from lowering the local sales tax rate or changing the allocation of local sales tax revenues without meeting certain conditions. See "STATE FINANCES — Local Governments."

Corporation Tax

Corporation tax revenues are derived from the following taxes:

1. The franchise tax and the corporate income tax are levied at an 8.84 percent rate on profits. The former is imposed on corporations for the privilege of doing business in California, while the latter is imposed on corporations that derive income from California sources but are not sufficiently present to be classified as doing business in the State.

2. Banks and other financial corporations are subject to the franchise tax plus an additional tax at the rate of 2 percent on their net income. This additional tax is in lieu of personal property taxes and business license taxes.

3. The AMT is similar to that in federal law. In general, the AMT is based on a higher level of net income computed by adding back certain tax preferences. This tax is imposed at a rate of 6.65 percent.

4. A minimum franchise tax of up to $800 is imposed on corporations subject to the franchise tax but not on those subject to the corporate income tax. New corporations are exempted from the minimum franchise tax for the first two years of incorporation.

5. Sub-Chapter S corporations are taxed at 1.5 percent of profits.

On February 23, 2004, the U.S. Supreme Court denied the State Franchise Tax Board's appeal requesting review of the decision in *Farmer Brothers Company v. Franchise Tax Board*, a tax refund case which involved the deductibility of corporate dividends. The exact amount and timing of such refunds is yet to be determined, although potential revenue losses could total $400 million over several fiscal years through 2007–08 (some revenue gains are expected in fiscal years after that). These revenue losses are included in State budget projections for fiscal years 2004–05 and 2005–06.

Insurance Tax

The majority of insurance written in California is subject to a 2.35 percent gross premium tax. For insurers, this premium tax takes the place of all other state and local taxes except those on real property and motor vehicles. Exceptions to the 2.35 percent rate are certain pension and profit-sharing plans which are taxed at the lesser rate of 0.5 percent, surplus lines and nonadmitted insurance at 3 percent and ocean marine insurers at 5 percent of underwriting profits.

Estate Tax; Other Taxes

The California estate tax is based on the State death tax credit allowed against the federal estate tax. The California estate tax is designed to pick up the maximum credit allowed against the federal estate tax return. The federal Economic Growth and Tax Relief Reconciliation Act of 2001 (the "Economic Growth and Tax Relief Reconciliation Act") phases out the federal estate tax by 2010. As a consequence, the Economic Growth and Tax Relief Reconciliation Act resulted in the reduction of the State estate tax revenues by 25 percent in calendar year 2002, 50 percent in calendar year 2003, and 75 percent in calendar year 2004, and the elimination of the State estate tax beginning in calendar year 2005. The provisions of this federal act sunset after 2010. At that time, the federal estate tax will be reinstated along with the State's estate tax, unless future federal legislation is enacted to make the provisions permanent. See Table 4 entitled "COMPARATIVE YIELD OF STATE TAXES — ALL FUNDS, 2000–01 THROUGH 2005–06."

Other General Fund major taxes and licenses include: Inheritance and Gift Taxes; Cigarette Taxes; Alcoholic Beverage Taxes; Horse Racing License Fees and Trailer Coach License Fees.

Special Fund Revenues

The California Constitution and statutes specify the uses of certain revenue. Such receipts are accounted for in various special funds. In general, special fund revenues comprise three categories of income:

- Receipts from tax levies which are allocated to specified functions, such as motor vehicle taxes and fees and certain taxes on tobacco products.

- Charges for special services to specific functions, including such items as business and professional license fees.

- Rental royalties and other receipts designated for particular purposes (e.g., oil and gas royalties).

Motor vehicle related taxes and fees accounted for about 40 percent of all special fund revenues in fiscal year 2003–04. Principal sources of this income are motor vehicle fuel taxes, registration and weight fees and vehicle license fees. During fiscal year 2003–04, $7.7 billion was derived from the ownership or operation of motor vehicles. About $3.2 billion of this revenue was returned to local governments. The remainder was available for various State programs related to transportation and services to vehicle owners. For a discussion of proposed agreements to replace vehicle license fees with increased property tax revenues, see "STATE FINANCES – Local Governments – Vehicle License Fee."

Taxes on Tobacco Products

As a result of Proposition 99, approved by the voters in 1988, and Proposition 10, approved by the voters in 1998, the State imposes an excise tax on cigarettes of 87 cents per pack and the equivalent rates on other tobacco products. Tobacco product excise tax revenues are earmarked as follows:

1. Fifty cents of the per-pack tax on cigarettes and the equivalent rate levied on non-cigarette tobacco products are deposited in the California Children and Families First Trust Fund and are allocated primarily for early childhood development programs.

2. Twenty-five cents of the per-pack tax on cigarettes and the equivalent rates levied on non-cigarette tobacco products are allocated to the Cigarette and Tobacco Products Surtax Fund. These funds are appropriated for anti-tobacco education and research, indigent health services, and environmental and recreation programs.

3. Ten cents of the per-pack tax is allocated to the State's General Fund.

4. The remaining two cents of the per-pack tax is deposited into the Breast Cancer Fund.

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Recent Tax Receipts

The following table shows the trend of major General Fund and total taxes per capita and per $100 of personal income for the past four years, the current fiscal year, and the 2005–06 budget year.

TABLE 3
RECENT TAX RECEIPTS

	Trend of State Taxes per Capita[(a)]		Taxes per $100 of Personal Income	
Fiscal Year	**General Fund**	**Total**	**General Fund**	**Total**
2000–01	$2,219.08	$2,585.05	$6.85	$7.99
2001–02	1,801.21	2,105.46	5.52	6.45
2002–03	1,833.10	2,133.14	5.65	6.57
2003–04[(b)]	1,948.69	2,265.02	5.92	6.88
2004–05[(c)]	2,084.27	2,453.59	6.09	7.17
2005–06[(c)]	2,194.86	2,582.35	6.16	7.25

(a) Data reflect population figures based on the 2000 Census.

(b) Preliminary.

(c) Estimated.

Source: State of California, Department of Finance.

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The following table gives the actual and estimated revenues by major source for the last four years, the current fiscal year, and the 2005–06 budget year. This table shows taxes that provide revenue both to the General Fund and State special funds.

TABLE 4
COMPARATIVE YIELD OF STATE TAXES — ALL FUNDS
2000–01 THROUGH 2005–06
(Modified Accrual Basis)
(Thousands)

Year Ending June 30	Sales and Use[(a)]	Personal Income	Corporation	Tobacco	Inheritance, Estate and Gift[(b)]	Insurance	Alcoholic Beverages	Horse Racing	Motor Vehicle Fuel[(c)]	Motor Vehicle Fees[(d)]
2001	$26,616,073[(f)]	$44,618,532	$6,899,322	$1,150,869	$934,709	$1,496,556	$288,450	$42,360	$3,142,142	$5,286,542
2002	26,004,521[(f)]	33,051,107	5,333,030	1,102,806	890,627	1,595,846	292,627	42,247	3,295,903	3,836,795
2003	27,177,756[(f)]	32,713,830	6,803,583	1,055,505	647,372	1,879,784	290,564	40,509	3,202,512	3,965,410
2004	28,948,622	36,406,312	7,019,225	1,081,587	397,849	2,114,979	312,826	40,767	3,324,883	4,426,783
2005[(e)]	29,265,591[(g)]	39,781,000[(h)]	8,678,000	1,064,700	209,000	2,230,000	312,000	42,799	3,357,313	4,838,356
2006[(e)]	31,278,514[(g)]	43,578,000[(h)]	9,015,000	1,034,700	0	2,300,000	315,000	42,799	3,440,973	5,014,106

(a) Numbers include local tax revenue from the 0.5 percent rate increase dedicated to local governments for the State-local health and welfare program realignment program. The 0.5 percent rate is equivalent to about $2.4 billion to $2.7 billion per year. The figures also reflect a statutory 0.25 percent reduction that occurred only during calendar year 2001.

(b) The State estate tax is based on the State death tax credit allowed against the federal estate tax. As a result, the federal Economic Growth and Tax Relief Reconciliation Act progressively reduced the State estate tax in calendar years 2002 through 2004 and eliminates it beginning in calendar year 2005.

(c) Motor vehicle fuel tax (gasoline), use fuel tax (diesel and other fuels), and jet fuel.

(d) Registration and weight fees, motor vehicle license fees and other fees. Represents a reduction of vehicle license fee rate on July 1, 2001 from 1.3% of vehicle depreciable value to 0.65%. Effective July 1, 2005, the rate was reset at 0.65%.

(e) Estimated as of January 10, 2005.

(f) The figures do not include voter approved local revenue, the 1 percent local city and county operations revenue (Bradley-Burns), or the 0.25 percent county transportation funds revenue. Figures do include the 0.5 percent Local Public Safety Fund revenue.

(g) Unlike the figures for fiscal years ending June 30, 2001 through June 30, 2004, these estimated figures do not include the 0.5 percent Local Public Safety Fund revenue. These estimated figures also do not include voter approved local revenue, the 1 percent local city and county operations revenue (Bradley-Burns), or the 0.25 percent county transportation funds revenue. Estimate for fiscal year 2004–05 includes $1.167 billion and for fiscal year 2005–06 includes $1.358 billion for a temporary one-quarter cent tax increase to be deposited in the Fiscal Recovery Fund and used for repayment of the economic recovery bonds. See "Sources of Tax Revenue — Sales Tax."

(h) Includes the revenue estimate for a 1 percent surcharge on taxpayers with taxable income over $1 million, with the proceeds funding mental health programs pursuant to Proposition 63.

NOTE: This table shows taxes that provide revenue both to the General Fund and State special funds. Also, some revenue sources are dedicated to local governments. This accounts for differences between the information in this table and Table 12.

Source: Fiscal years 2000–01 through 2003–04: State of California, Office of the State Controller.
Fiscal years 2004–05 and 2005–06: State of California, Department of Finance.

State Expenditures

The following table summarizes the major categories of State expenditures, including both General Fund and special fund programs.

TABLE 5
GOVERNMENTAL COST FUNDS
(Budgetary Basis)
Schedule of Expenditures by Function and Character
Fiscal Years 1999–00 to 2003–04
(Thousands)

	1999–00	2000–01	2001–02	2002–03	2003–04
Function					
Legislative, Judicial, Executive					
Legislative	$ 232,323	$ 262,370	$ 265,312	$ 276,462	$ 284,894
Judicial[a]	1,372,681	1,478,710	1,633,518	2,524,446	2,634,409
Executive	1,241,219	1,352,128	1,371,891	1,283,297	1,329,557
State and Consumer Services	856,096	950,192	1,100,942	955,054	946,584
Business, Transportation and Housing					
Business and Housing	156,499	601,053	240,237	184,573	235,742
Transportation	5,549,520	4,417,139	6,052,926	3,712,133	6,077,810
Technology, Trade and Commerce[b]	488,489	140,833	81,832	50,335	10,262
Resources	1,858,844	3,349,003	2,284,269	1,993,957	2,100,200
Environmental Protection	689,678	869,539	993,144	762,052	749,988
Health and Human Services	21,806,291	24,204,531	26,563,743	27,420,865	26,793,410
Correctional Programs	4,412,542	4,952,927	5,242,369	5,614,849	5,246,381
Education					
Education–K through 12	26,356,838	28,720,596	28,078,228	27,611,356	28,696,655
Higher Education	8,553,343	9,655,954	9,945,193	9,951,749	9,487,413
Labor and Workforce Development[c]	N/A	N/A	N/A	250,616	239,051
General Government					
General Administration	982,923	1,294,587	2,475,564	1,830,280	3,580,718
Debt Service	2,072,960	2,270,649	2,432,942	2,067,815	2,103,756
Tax Relief	1,840,129	4,655,826	3,028,703	4,446,940	3,782,731
Shared Revenues	3,677,687	4,385,429	5,528,996	2,784,970	2,664,766
Brown vs. US Dept. of Health and Human Services	–	–	96,000	–	–
Other Statewide Expenditures	580,307	635,475	476,170	526,863	825,833
Expenditure Adjustment for Encumbrances[d]	(628,506)	(1,943,208)	(681,856)	2,365,728	363,473
Credits for Overhead Services by General Fund	(170,594)	(197,343)	(251,575)	(288,871)	(326,928)
Statewide Indirect Cost Recoveries	(37,423)	(36,610)	(47,862)	(50,313)	(59,081)
Total	$81,891,846	$92,019,780	$96,910,686	$96,275,156	$97,767,624
Character					
State Operations	$22,864,874	$24,850,286	$27,994,343	$26,241,065	$28,208,541
Local Assistance	58,369,828	66,087,018	67,993,721	69,043,191	68,086,507
Capital Outlay	657,144	1,082,476	922,622	990,900	1,472,576
Total	$81,891,846	$92,019,780	$96,910,686	$96,275,156	$97,767,624

(a) Included in this amount are the expenditures of the Trial Court Trust Fund. As of July 1, 2002, the Trial Court Trust Fund was reclassified to a Governmental Cost Fund from a Non-Governmental Cost Fund.

(b) As of January 2004, Technology, Trade and Commerce was abolished per Assembly Bill 1757 of 2003, Chapter 229. Funds that were abolished were transferred to the General Fund.

(c) Legislation was enacted effective January 1, 2003 which created a new agency function called the Labor and Workforce Development. Fiscal year 2002–03 figure reflects the expenditure for the entire fiscal year. The following agencies were transferred from General Government to this new function: the Employment Development Department, the California Workforce Investment Board, the Agricultural Labor Relations Board, and the Department of Industrial Relations.

(d) Expenditures for the State Highway Account (Fund 0042) and the Traffic Congestion Relief Fund (Fund 3007) are reported on a modified cash basis. This method of accounting eliminated all of the continuing appropriations in these two funds.

N/A – Not applicable

Source: State of California, Office of the State Controller.

State Appropriations Limit

The State is subject to an annual appropriations limit imposed by Article XIII B of the State Constitution (the "Appropriations Limit"). The Appropriations Limit does not restrict appropriations to pay debt service on voter-authorized bonds.

Article XIII B prohibits the State from spending "appropriations subject to limitation" in excess of the Appropriations Limit. "Appropriations subject to limitation," with respect to the State, are authorizations to spend "proceeds of taxes," which consist of tax revenues, and certain other funds, including proceeds from regulatory licenses, user charges or other fees to the extent that such proceeds exceed "the cost reasonably borne by that entity in providing the regulation, product or service," but "proceeds of taxes" exclude most State subventions to local governments, tax refunds and some benefit payments such as unemployment insurance. No limit is imposed on appropriations of funds which are not "proceeds of taxes," such as reasonable user charges or fees and certain other non-tax funds.

There are various types of appropriations excluded from the Appropriations Limit. For example, debt service costs of bonds existing or authorized by January 1, 1979, or subsequently authorized by the voters, appropriations required to comply with mandates of courts or the federal government, appropriations for qualified capital outlay projects, appropriations for tax refunds, appropriations of revenues derived from any increase in gasoline taxes and motor vehicle weight fees above January 1, 1990 levels, and appropriation of certain special taxes imposed by initiative (e.g., cigarette and tobacco taxes) are all excluded. The Appropriations Limit may also be exceeded in cases of emergency.

The Appropriations Limit in each year is based on the Appropriations Limit for the prior year, adjusted annually for changes in State per capita personal income and changes in population, and adjusted, when applicable, for any transfer of financial responsibility of providing services to or from another unit of government or any transfer of the financial source for the provisions of services from tax proceeds to non-tax proceeds. The measurement of change in population is a blended average of statewide overall population growth, and change in attendance at local school and community college ("K-14") districts. The Appropriations Limit is tested over consecutive two-year periods. Any excess of the aggregate "proceeds of taxes" received over such two-year period above the combined Appropriations Limits for those two years, is divided equally between transfers to K-14 districts and refunds to taxpayers.

The Legislature has enacted legislation to implement Article XIII B which defines certain terms used in Article XIII B and sets forth the methods for determining the Appropriations Limit. California Government Code Section 7912 requires an estimate of the Appropriations Limit to be included in the Governor's Budget, and thereafter to be subject to the budget process and established in the Budget Act.

The following table shows the Appropriations Limit for fiscal years 2001–02 through 2005–06.

As of the release of the 2005–06 Governor's Budget, the Department of Finance projected the Appropriations Subject to Limit to be $9.376 billion and $9.706 billion under the Appropriations Limit in fiscal years 2004–05 and 2005–06, respectively.

TABLE 6
STATE APPROPRIATIONS LIMIT
(Millions)

	Fiscal Years				
	2001–02	**2002–03**	**2003–04**	**2004–05**	**2005–06**
State Appropriations Limit	$59,318	$59,591	$61,702	$64,588	$68,479*
Appropriations Subject to Limit	(42,240)	(45,832)	(47,844)	(55,212)*	(58,773)*
Amount (Over)/Under Limit	$17,078	$13,759	$13,858	$9,376*	$9,706*

* Estimated/Projected.

Source: State of California, Department of Finance.

Proposition 98

On November 8, 1988, the voters of the State approved Proposition 98, a combined initiative constitutional amendment and statute called the "Classroom Instructional Improvement and Accountability Act." Proposition 98 changed State funding of public education below the university level and the operation of the State Appropriations Limit, primarily by guaranteeing K-14 schools a minimum amount of General Fund revenues. Proposition 98 (as modified by Proposition 111, enacted on June 5, 1990) guarantees K-14 schools the greater of: (a) in general, a fixed percentage of General Fund revenues ("Test 1"), (b) the amount appropriated to K-14 schools in the prior year, adjusted for changes in State per capita personal income and enrollment ("Test 2"), or (c) a third test, which replaces Test 1 and Test 2 in any year the percentage growth in per capita General Fund revenues from the prior year plus one half of one percent is less than the percentage growth in State per capita personal income ("Test 3").

Legislation adopted prior to the end of the 1988–89 fiscal year implementing Proposition 98 determined the K–14 schools' funding guarantee under Test 1 to be 40.7 percent of General Fund tax revenues, based on 1986–87 appropriations. However, this percentage has since been adjusted to approximately 39.0 percent of 1986–87 appropriations to account for subsequent changes in the allocation of local property taxes, since these changes altered the share of General Fund revenues received by schools. The Proposition 98 guarantee has typically been calculated under Test 2, with the exception of four years which were calculated under Test 3. Under Test 3, schools receive the amount appropriated in the prior year adjusted for changes in enrollment and per capita General Fund revenues, plus 0.5 percent. If Test 3 is used in any year, the difference between Test 3 and Test 2 becomes a "credit" (called the "maintenance factor") to schools and becomes the basis of payments in future years when per capita General Fund revenue growth exceeds per capita personal income growth. The Governor's Budget Reform Proposals would eliminate the Test 3 calculation. See "THE BUDGET PROCESS — Governor's Budget Reform Proposals" and "CURRENT STATE BUDGET AND GOVERNOR'S PROPOSED 2005–06 BUDGET — Governor's Budget Reform Proposals and Related Initiative."

The Proposition 98 guarantee is funded from two sources: local property taxes and the General Fund. Any amount not funded by local property taxes is funded by the General Fund. Thus, local property tax collections represent an offset to General Fund costs in a Test 2 or Test 3 year.

Proposition 98 implementing legislation adopted prior to the end of the 1988–89 fiscal year determined the K-14 schools' funding guarantee under Test 1 to be 40.3 percent of the General Fund tax revenues, based on 1986–87 appropriations. However, this funding guarantee has been adjusted to approximately 39 percent of 1986–87 appropriations to account for subsequent changes in the allocation of local property taxes, since these changes altered the share of General Fund revenues received by schools. Proposition 98 also contains provisions for the transfer of certain State tax revenues in excess of the Article XIII B limit to K-14 schools in Test 1 years when additional moneys are available. No such transfers are anticipated during fiscal years 2004–05 and 2005–06. See "STATE FINANCES — State Appropriations Limit."

The 2005–06 Governor's Budget reflects General Fund Proposition 98 expenditures in fiscal years 2003–04 through 2005–06, as outlined in the table below. The 2005–06 Governor's Budget includes full funding for statutory growth (0.79 percent) and COLA (3.93 percent) adjustments, and also reflects the deferral of Proposition 98 expenditures of $1.297 billion from fiscal years 2003–04 to 2004–05, $1.283 billion from fiscal years 2004–05 to 2005–06, and $1.303 billion from fiscal years 2005–06 to 2006–07.

TABLE 7
Proposition 98 Funding
($ in Millions)

	2003–04		2004–05		2005–06	Change From Revised 2004–05	
	Enacted	**Revised**	**Enacted**	**Revised**	**Proposed**	**Amount**	**Percent**
K-12 Proposition 98							
State General Fund	$27,630	$28,154	$30,873	$30,992	$33,117	$2,125	6.86%
Local property tax revenue	13,625	13,656	11,214	11,192	11,593	401	3.58
Subtotals[a]	$41,255	$41,810	$42,087	$42,183	$44,710	$2,527	5.99%
Other Proposition 98							
State General Fund	$2,353	$2,368	$3,130	$3,132	$3,415	$ 283	9.04%
Local property tax revenue	2,105	2,098	1,772	1,767	1,842	75	4.24
Subtotals[a]	$4,458	$4,466	$4,902	$4,900	$5,258	$ 358	7.31%
Total Proposition 98							
State General Fund	$29,983	$30,522	$34,003	$34,124	$36,532	$2,408	7.06%
Local property tax revenue	15,730	15,754	12,986	12,959	13,435	476	3.67
Totals[a]	$45,713	$46,276	$46,989	$47,083	$49,968	$2,885	6.13%

(a) Totals may not add due to rounding.

Source: State of California, Department of Finance

Proposition 98 permits the Legislature, by a two-thirds vote of both houses (on a bill separate from the Budget Act), and with the Governor's concurrence, to suspend the K-14 schools' minimum funding guarantee for a one-year period. Restoration of the Proposition 98 funding level to the level that would have been required in the absence of such a suspension occurs over future fiscal years according to a specified State Constitutional formula. The Governor's Budget Reform Proposals would eliminate the ability of the Legislature to suspend the minimum funding guarantee. See "THE BUDGET PROCESS — Governor's Budget Reform Proposals" and "CURRENT STATE BUDGET AND GOVERNOR'S PROPOSED 2005–06 BUDGET — Governor's Budget Reform Proposals and Related Initiative."

Legislation related to the 2004 Budget Act suspended the Proposition 98 minimum guarantee. At the time the 2004 Budget Act was enacted, this suspension was estimated to be $2.004 billion. However, subsequent growth in General Fund revenue has increased the estimated 2004–05 Proposition 98 guarantee calculation by an additional $1.112 billion, bringing the total value of the suspension to $3.116 billion. The Administration does not propose additional 2004–05 Proposition 98 appropriations in the 2005–06 Governor's Budget. This suspended amount is added to the existing maintenance factor (defined above), for a total estimated maintenance factor balance of $3.739 billion at the end of fiscal year 2005–06. As the factors used to determine this amount for fiscal year 2004–05 are not yet fixed, this amount may change and will be re-estimated during the 2005–06 May Revision. The maintenance factor balance is required to be restored to the Proposition 98 budget over future years as explained above. Therefore, suspending the minimum funding guarantee provides ongoing General Fund savings over multiple fiscal years until the maintenance factor is fully repaid. The Governor's Budget Reform Proposal would require this estimated $3.739 billion maintenance factor to be paid within 15 years, and that such payments would no longer increase the Proposition 98 base calculation for future years. See "THE BUDGET PROCESS — Governor's Budget Reform Proposals" and "CURRENT STATE BUDGET AND GOVERNOR'S PROPOSED 2005–06 BUDGET — Governor's Budget Reform Proposals and Related Initiative."

Appropriations for fiscal years 2002–03 and 2003–04 are currently estimated to be $474.6 million and $526.9 million, respectively, below the amounts required by Proposition 98 because of increases in State tax revenues above previous estimates. Legislation enacted in August 2004 annually appropriates $150 million per year, beginning in fiscal year 2006–07, to repay prior year Proposition 98 obligations through the 2003–04 fiscal year, including $250.8 million owed from the 1995–96 and 1996–97 fiscal years, until these obligations are fully repaid. The current estimate of these prior year obligations is $1.252 billion. Under the Governor's Budget Reform Proposal, this obligation instead would be repaid within 15 years. See "THE BUDGET PROCESS — Governor's Budget Reform Proposals" and "CURRENT STATE BUDGET AND GOVERNOR'S PROPOSED 2005–06 BUDGET — Governor's Budget Reform Proposals and Related Initiative."

Local Governments

The primary units of local government in California are the counties, which range in population from 1,200 in Alpine County to approximately 10 million in Los Angeles County. Counties are responsible for the provision of many basic services, including indigent health care, welfare, jails, and public safety in unincorporated areas. There are also 478 incorporated cities and thousands of special districts formed for education, utilities, and other services. The fiscal condition of local governments has been constrained since Proposition 13, which added Article XIII A to the State Constitution ("Proposition 13"), was approved by California voters in 1978. Proposition 13 reduced and limited the future growth of property taxes and limited the ability of local governments to impose "special taxes" (those devoted to a specific purpose) without two-thirds voter approval. Proposition 218, another initiative constitutional amendment enacted in 1996, further limited the ability of local governments to raise taxes, fees, and other exactions. Counties, in particular, have had fewer options to raise revenues than many other local government entities, while they have been required to maintain many services.

In the aftermath of Proposition 13, the State provided aid to local governments from the General Fund to make up some of the loss of property tax moneys, including assuming principal responsibility for funding K-12 schools and community colleges. During the recession of the early 1990s, the Legislature eliminated most of the remaining components of post-Proposition 13 aid to local government entities other than K-12 schools and community colleges by requiring cities and counties to transfer some of their property tax revenues to school districts. However, the Legislature also provided additional funding sources, such as sales taxes, and reduced certain mandates for local services funded by cities and counties. See "STATE FINANCES — Sources of Tax Revenue — Sales Tax" for a discussion of the impact of the economic recovery bond issuances on local sales taxes.

The 2004 Budget Act, related legislation and the enactment of Senate Constitutional Amendment No. 4 (described below) dramatically changed the State-local fiscal relationship. These constitutional and statutory changes implemented an agreement negotiated between the Governor and local government officials (the "State–local agreement") in connection with the 2004 Budget Act. One change relates to the reduction of the vehicle license fee ("VLF") rate from 2 percent to 0.65 percent of the market value of the vehicle. In order to protect local governments, which have previously received all VLF revenues, the reduction in VLF revenue to cities and counties from this rate change was replaced by an increase in the amount of property tax they receive. Under the State-local agreement and implementing legislation, for fiscal years 2004–05 and 2005–06 only, the replacement property taxes that cities and counties receive are reduced by $700 million. In future years, local governments will receive the full value of the VLF revenue, as described under "— Vehicle License Fee" below. Also for these two fiscal years, redevelopment agencies are required to shift $250 million, and special districts to shift $350 million, in property tax revenues they would otherwise receive to schools.

As part of the State-local agreement, Senate Constitutional Amendment No. 4 was enacted by the Legislature and subsequently approved by the voters as Proposition 1A ("Proposition 1A") at the November 2004 election. Proposition 1A amended the State Constitution to, among other things, reduce the Legislature's authority over local government revenue sources by placing restrictions on the State's access to local governments' property, sales, and vehicle license fee revenues as of November 3, 2004. Beginning with fiscal year 2008–09, the State will be able to borrow up to 8 percent of local property tax revenues, but only if the Governor proclaims such action is necessary due to a severe State fiscal hardship, two–thirds of both houses of the Legislature approves the borrowing and the amount borrowed is required to be paid back within three years. The State also will not be able to borrow from local property tax revenues for more than 2 fiscal years within a period of 10 fiscal years, and only if previous borrowings have been repaid. In addition, the State cannot reduce the local sales tax rate or restrict the authority of the local governments to impose or change the distribution of the statewide local sales tax. Proposition 1A also prohibits the State from mandating activities on cities, counties or special districts without providing for the funding needed to comply with the mandates. Beginning in fiscal year 2005–06, if the State does not provide funding for the activity that has been determined to be mandated, the requirement on cities, counties or special districts to abide by the mandate would be suspended. In addition, Proposition 1A expanded the definition of what constitutes a mandate to encompass State action that transfers to cities, counties and special districts financial responsibility for a required program for which the State previously had partial or complete responsibility. The State mandate provisions of Senate Proposition 1A do not apply to schools or community colleges or to mandates relating to employee rights. See "THE BUDGET PROCESS — Constraints on the Budget Process — Proposition 1A."

Vehicle License Fee

Prior to enactment of the 2004 Budget Act, vehicle license fees were assessed in the amount of 2 percent of a vehicle's depreciated market value for the privilege of operating a vehicle on California's public highways. A program to offset (or reduce) a portion of the VLF paid by vehicle owners was established by Chapter 322, Statutes of 1998. Beginning January 1, 1999, a permanent offset of 25 percent of the VLF paid by vehicle owners became operative. Various pieces of legislation increased the amount of the offset in subsequent years to the existing statutory level of 67.5 percent of two percent (resulting in an effective rate of 0.65 percent). This level of offset provided tax relief of $4.3 billion in fiscal year 2003–04.

In connection with the offset of the VLF, the Legislature authorized appropriations from the State General Fund to "backfill" the offset so that local governments, which receive all of the vehicle license fee revenues, would not experience any loss of revenues. The legislation that established the VLF offset program also provided that if there were insufficient General Fund moneys to fully "backfill" the VLF offset, the percentage offset would be reduced proportionately (i.e., the license fee payable by drivers would be increased) to assure that local governments would not be disadvantaged. In June 2003, the Director of Finance under the Davis Administration ordered the suspension of VLF offsets due to a determination that insufficient General Fund moneys would be available for this purpose, and, beginning in October 2003, VLF paid by vehicle owners were restored to the 1998 level. However, the offset suspension was rescinded by Governor Schwarzenegger on November 17, 2003, and offset payments to local governments resumed. Local governments received "backfill" payments totaling $3.80 billion in fiscal year 2002–03 and $3.1 billion in fiscal year 2003–04. In addition, the State-local agreement also provides for the repayment in August 2006 of approximately $1.2 billion that was not received by local governments during the time period between the suspension of the offsets and the implementation of higher fees.

Beginning in fiscal year 2004–05, the State-local agreement permanently reduced the VLF rate to 0.65 percent, and eliminated the General Fund offset program. The State Constitution, amended by the voter approval of Proposition 1A in the November 2004 election, codifies the obligation of the State to provide replacement revenues to local governments for revenues lost as a result of the decrease in VLF rate below the current level of 0.65 percent of the market value of the vehicle.

In an unpublished decision issued in September 2003, the Court of Appeal (*County of San Diego v. Commission on State Mandates, et al.*, D039471; petition for review denied by the California Supreme Court, in December, 2003) ruled in favor of the County of San Diego on certain claims related to the medically indigent adult program. See "LITIGATION — Local Government Mandate Claims and Actions." The decision triggered the automatic reduction in VLF payments to local governments, by making the statutory depreciation schedule, enacted as part of the 1991 program realignment between State and local governments, inoperative as of March 1, 2004. In response to this reduction, the Department of Motor Vehicles ("DMV") adopted emergency regulations to offset this reduction in revenues. Subsequently, legislation was approved to reinstate the authority to transfer VLF revenues to the counties. The reinstatement is made permanent by amendments to certain provisions of the State Constitution as a result of the voter approval of Proposition 1A in the November 2004 election.

Trial Courts

Prior to legislation enacted in 1997, local governments provided the majority of funding for the State's trial court system. The legislation consolidated the trial court funding at the State level in order to streamline the operation of the courts, provide a dedicated revenue source, and relieve fiscal pressure on the counties. The State's trial court system will receive approximately $2 billion and $2.2 billion in State resources in fiscal years 2004–05 and 2005–06, respectively, and $475 million in resources from the counties in each fiscal year.

Welfare System

The entire statewide welfare system was changed in response to the change in federal welfare law enacted in 1996 (see "Welfare Reform"). Under the CalWORKs (defined below) program, counties are given flexibility to develop their own plans, consistent with State law, to implement the program and to administer many of its elements, with costs for administrative and supportive services capped at the 1996–97 levels. As noted above, counties are also given financial incentives if, at the individual county level or statewide, the CalWORKs program produces savings associated with specified standards. Counties are still required to provide "general assistance" aid to certain persons who cannot obtain welfare from other programs.

Welfare Reform

The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (P.L. 104–193, the "Law") fundamentally reformed the nation's welfare system. The Law included provisions to: (i) convert Aid to Families with Dependent Children ("AFDC"), an entitlement program, to Temporary Assistance for Needy Families ("TANF"), a block grant program with lifetime time limits on TANF recipients, work requirements and other changes; (ii) deny certain federal welfare and public benefits to legal noncitizens (subsequent federal law has amended this provision), allow states to elect to deny additional benefits (including TANF) to legal noncitizens, and generally deny almost all benefits to illegal immigrants; and (iii) make changes in the Food Stamp program, including to reduce maximum benefits and impose work requirements. The block grant formula under the Law is operative through June 30, 2005, as further described below.

Chapter 270, Statutes of 1997, embodies California's response to the federal welfare reforms. Effective January 1, 1998, California Work Opportunity and Responsibility to Kids ("CalWORKs") replaced the former AFDC and Greater Avenues to Independence programs. Consistent with the federal law, CalWORKs contains time limits on the receipt of welfare aid, both lifetime as well as current period. The centerpiece of CalWORKs is the linkage of eligibility to work participation requirements.

Caseload under CalWORKs is continuing to flatten after many consecutive years of decline. The revised CalWORKs caseload projections are 495,000 cases in fiscal year 2004–05 and 473,000 cases in fiscal year 2005–06. This represents a major decline in caseload from the rapid growth of the early 1990s, when caseload peaked at 921,000 cases in fiscal year 1994–95. Since CalWORKs' inception in January 1998, caseload has declined by nearly 33 percent, and the number of working recipients has increased from less than 20 percent in 1996 to nearly 50 percent in 2003.

California will continue to meet, but not exceed, the federally-required $2.7 billion combined State and county maintenance of effort ("MOE") requirement in fiscal years 2004–05 and 2005–06. In an effort to keep program expenditures within the TANF Block Grant and TANF MOE amounts, and to better align CalWORKs program benefits with TANF programs in other states, the 2005–06 Governor's Budget proposes to (1) eliminate the statutory requirement to provide an automatic annual grant cost-of-living adjustment; (2) build on reforms included in the 2004 Budget Act to strengthen the work focus of the CalWORKs program; (3) reduce the earned income disregard to allow CalWORKs families to keep $200 and 40 percent of remaining earned income rather than the current $225 and 50 percent of remaining earned income; (4) implement a new incentive system that bases a portion of the counties' single allocation for administration and employment services on specific outcomes of CalWORKs clients in each county; and (5) reduce grants by 6.5 percent to align benefit levels better with TANF programs in other states. These and other smaller CalWORKs program reductions are projected to result in General Fund savings totaling $336.3 million in the CalWORKs budget and $316.5 million in other programs by using federal TANF Block Grant funds to offset eligible General Fund expenditures in other departments.

The 2005–06 Governor's Budget includes total CalWORKs-related expenditures of $6.6 billion for fiscal year 2004–05 and $6.7 billion for fiscal year 2005–06, which includes an augmentation of $191.9 million in each year for employment services to enable recipients to move off of aid and into sustainable employment. The 2005–06 Governor's Budget includes a TANF reserve of $136 million, which is available for unanticipated needs in any program for which TANF Block Grant funds are appropriated, including CalWORKs benefits, employment services, county administration, and child care costs. This reserve may be needed for such pressures as litigation or the cost of increased participation rate requirements that have been proposed at the federal level with the reauthorization of the TANF program.

Authorization for the TANF program currently ends June 30, 2005 (having been extended several times from its original September 30, 2002 expiration date). For the TANF program to continue, the U.S. Congress must pass, and the President must sign, legislation reauthorizing the program prior to that date. While Congress and the President will consider several key policy changes, federal reauthorization legislation introduced to date would significantly increase the work participation rate requirements. One proposal would increase work participation rate requirements by 5 percent annually from the current statutory rate of 50 percent to 70 percent in federal fiscal year 2010. The State would need to make substantial investments in child care and employment services in order to meet the increased work participation rate requirements if this proposal was adopted. Failure to meet these increased requirements could result in significant federal penalties.

Pension Trusts

The assets and liabilities of the three principal retirement systems in which the State participates, CalPERS, the California State Teachers' Retirement System ("CalSTRS") and the University of California Retirement System ("UCRS"), are included in the financial statements of the State as fiduciary funds and described in Note 23 to the Audited Annual Financial Statements of the State of California for the year ended June 30, 2004 (the "Audited Financial Statements"), incorporated by reference in or attached to this APPENDIX A. See "FINANCIAL STATEMENTS."

The three largest defined benefit retirement plans contained in the retirement systems and the excess of the actuarial value of assets over the actuarial accrued liability or unfunded actuarial accrued liability of those plans at June 30, 2003 was reported to be as follows:

TABLE 8
ACTUARIAL VALUE OF STATE RETIREMENT SYSTEMS

Name of Plan	Excess of Actuarial Value of Assets Over Actuarial Accrued Liabilities (Unfunded Actuarial Accrued Liability)
Public Employees' Retirement Fund (CalPERS)(1)	$ (11.935) billion
State Teachers' Retirement Fund Defined Benefit Program (CalSTRS)	(23.110) billion
University of California Retirement Plan	6.259 billion

(1) Excludes the value of the local government plans of the system.

According to CalSTRS, its investment portfolio market value as of July 31, 2004, was approximately $116,177,000,000, compared to $100,893,000,000 as of July 31, 2003. The CalPERS reports that its investment portfolio market value as of July 31, 2004, was approximately $166,300,000,000 compared to $144,800,000,000 as of July 31, 2003.

The State's contribution to the CalPERS and the UC Retirement System is actuarially determined each year, while the State's contribution to the CalSTRS Defined Benefit Program is established by statute. The contribution to CalSTRS is currently 2.017 percent of teacher payroll for the fiscal year ending in the immediately preceding calendar year. However, the Governor's Budget proposes to eliminate this contribution and shift this cost to the school districts in order to ensure an effective link between future costs and benefits of the teachers' retirement system. The State must also contribute

2.5 percent of teacher payroll to the Supplemental Benefits Maintenance Account, which is a purchasing power protection reserve.

The State also provides post-employment health care and dental benefits to its employees, and recognizes these costs on a "pay-as-you-go" basis. The cost of these benefits in fiscal year 2005–06 is estimated at $861 million, in comparison to an estimated $796 million in fiscal year 2004–05. On June 21, 2004, GASB released its Governmental Accounting Standard Board Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* ("Statement No. 45"). Statement No. 45 establishes standards for the measurement, recognition and display of post-employment healthcare as well as other forms of post-employment benefits, such as life insurance, when provided separately from a pension plan expense or expenditures and related liabilities in the financial reports of state and local governments. Under Statement No. 45, governments will be required to: (i) measure the cost of benefits, and recognize other post-employment benefits expense, on the accrual basis of accounting in periods that approximate employees' years of service; (ii) provide information about the actuarial liabilities for promised benefits associated with past services and whether, or to what extent, those benefits have been funded; and provide information useful in assessing potential demands on the employer's future cash flows. Statement 45 reporting requirements are effective for the State in the fiscal year beginning July 1, 2007. To date, the State has not actuarially computed its liability for post-employment health care benefits.

In 2004, CalSTRS actuaries determined that there was an unfunded liability associated with the 1990 benefit structure and, as a result, the State was required to pay an additional 0.524 percent ($92 million General Fund) in fiscal year 2004–05. It is expected that the 2004 valuation of CalSTRS will find the 1990 benefit structure to be fully funded and the State will not be required to make this additional contribution in fiscal year 2005–06. The following table shows the State's contributions to CalPERS for fiscal years 1997–98 through 2004–05 and its estimated contribution for 2005–06:

<u>TABLE 9</u>
STATE CONTRIBUTION TO CALPERS
Fiscal Years 1997–98 to 2005–06

1997–98	$1,223,000,000
1998–99	766,100,000
1999–00	463,600,000
2000–01	156,700,000
2001–02	677,200,000
2002–03	1,190,000,000
2003–04	2,213,000,000
2004–05	2,564,000,000
2005–06[1]	2,665,000,000

[1] Estimated

Due to past investment losses and increased retirement benefits, the State contribution to CalPERS has increased from $156.7 million in fiscal year 2000–01 to an estimated $2.564 billion in fiscal year 2004–05.

The 2005–06 Governor's Budget includes a pension reform package to reduce the State's future costs of pension contributions, estimated at $538 million (all funds) for fiscal year 2005–06. Starting in the 2005–06 budget year, employees will be expected to pay one-half the total charges approved by the CalPERS Board of Administration, including both the charges for normal costs and the charges for any unfunded liability. Implementation of this new method of funding the State's defined benefit pension plans for existing employees is contingent upon the renegotiation of collective bargaining agreements. The State is also proposing to permit State employees to opt out of CalPERS, in which case the State will share the savings by augmenting employee pay with an amount equal to 50 percent of the normal cost for that employee. The two options being proposed will allow employees to determine how valuable a defined benefit retirement program is as they look to the future, and spread the risks associated with defined benefit programs to all employees who determine that it is a valuable benefit. The 2005–06 Governor's Budget also assumes the issuance of $800 million of pension obligation bonds, yielding net proceeds of $765 million, to cover a portion of the State's retirement obligations for fiscal year 2005–06. See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS — Pension Obligation Bonds."

Additional information concerning the three largest plans and information concerning the other plans contained in the retirement systems can be found in Notes 23 and 24 to the Audited Financial Statements. See "FINANCIAL STATEMENTS."

Repayment of Energy Loans

The Department of Water Resources of the State ("DWR") borrowed $6.1 billion from the General Fund of the State for DWR's power supply program between January and June 2001. DWR issued approximately $11.25 billion in revenue bonds in several series and in the fall of 2002 used the net proceeds of the revenue bonds to repay outstanding loans from banks and commercial lenders in the amount of approximately $3.5 billion and a loan from the General Fund in the amount of $6.1 billion plus accrued interest of approximately $500 million.

The cost of the loans from the General Fund and the banks and commercial lenders that financed DWR's power supply program costs during 2001 exceeded DWR's revenues from the sale of electricity. Since that time, the power supply program has become self-supporting, and no additional loans from the General Fund are authorized. As of January 1, 2003, the DWR's authority to enter into new power purchase contracts terminated, and the three major investor-owned electric utilities (the "IOUs") resumed responsibility for obtaining electricity for their customers.

The general purpose of the power supply program has been to provide to customers of the IOUs the portion of their power not provided by the IOUs. The primary source of money to pay debt service on the DWR revenue bonds is revenues derived from customers of the IOUs resulting from charges set by the California Public Utilities Commission. The DWR revenue bonds are not a debt or liability of the State and do not directly or indirectly or contingently obligate the State to levy or to pledge any form of taxation whatever therefor or to make any appropriation for their payment.

Unemployment Insurance Fund

In fiscal year 2003–04, the State paid $6.715 billion in unemployment benefits from the Unemployment Insurance ("UI") Fund (which is not part of the General Fund). In fiscal year 2004–05, the State estimates it will pay $6.179 billion in benefits from the UI Fund. In calendar year 2004, the Employment Development Department ("EDD") obtained a cash flow loan from the United States Department of Labor to pay the unemployment benefits. The 2004 Budget Act contains provisional language authorizing up to $2.5 million in interest payments from the EDD Contingent Fund towards the repayment of the loan. However, because this loan was repaid prior to September 30, 2004, no interest is expected to be incurred in fiscal year 2004–05. Increased UI tax receipts and declining unemployment benefit claims have eliminated the need for additional borrowing in calendar year 2004, though the potential for calendar year 2005 borrowing remains. At this time, there is no estimate as to the projected deficit for the UI Fund in calendar year 2005.

Investment of Funds

Moneys on deposit in the State's Centralized Treasury System are invested by the Treasurer in the Pooled Money Investment Account ("PMIA"). As of March 31, 2005, the PMIA held approximately $33.4 billion of State moneys, and $18.0 billion invested for about 2,715 local governmental entities through the Local Agency Investment Fund ("LAIF"). The assets of the PMIA as of March 31, 2005, are shown in the following table:

TABLE 10
Analysis of the Pooled Money Investment Account Portfolio*

Type of Security	Amount (Thousands)	Percent of Total
U.S. Treasury	$ 8,435,330	16.4%
Commercial Paper	4,449,131	8.7
Certificates of Deposits	9,028,055	17.6
Corporate Bonds	1,547,599	3.0
Federal Agency	14,751,214	28.7
Bankers Acceptances	–	0.0
Bank Notes	450,000	0.9
Loans Per Government Code	5,908,620	11.5
Time Deposits	6,746,495	13.1
Repurchases	–	0.0
Reverse Repurchases	–	0.0
	$51,316,444	100.0%

* Totals may differ due to rounding.

Source: State of California, Office of the Treasurer.

The State's treasury operations are managed in compliance with the California Government Code and according to a statement of investment policy which sets forth permitted investment vehicles, liquidity parameters and maximum maturity of investments. The PMIA operates with the oversight of the PMIB. The LAIF portion of the PMIA operates with the oversight of the Local Agency Investment Advisory Board (consisting of the State Treasurer and four other appointed members).

The Treasurer does not invest in leveraged products or inverse floating rate securities. The investment policy permits the use of reverse repurchase agreements subject to limits of no more than 10 percent of the PMIA. All reverse repurchase agreements are cash matched either to the maturity of the reinvestment or an adequately positive cash flow date which is approximate to the maturity of the reinvestment.

The average life of the investment portfolio of the PMIA as of March 31, 2005 was 217 days.

THE BUDGET PROCESS

General

The State's fiscal year begins on July 1 and ends on June 30 of the following year. The State's General Fund Budget operates on a legal basis, generally using a modified accrual system of accounting for its General Fund, with revenues credited in the period in which they are measurable and available and expenditures debited in the period in which the corresponding liabilities are incurred.

The annual budget is proposed by the Governor by January 10 of each year for the next fiscal year (the "Governor's Budget"). Under State law, the annual proposed Governor's Budget cannot provide for projected expenditures in excess of projected revenues for the ensuing fiscal year. Following the submission of the Governor's Budget, the Legislature takes up the proposal. As required by the Balanced Budget Amendment ("Proposition 58") and as described below, beginning with fiscal year 2004–05, the Legislature may not pass a budget bill in which General Fund expenditures exceed estimated General Fund revenues and fund balances at the time of the passage and as set forth in the budget bill.

Under the State Constitution, money may be drawn from the Treasury only through an appropriation made by law. The primary source of annual expenditure appropriations is the annual Budget Act as approved by the Legislature and signed by the Governor. The Budget Act must be approved by a two-thirds majority vote of each House of the Legislature. See "THE BUDGET PROCESS — Constraints on the Budget Process" below. The Governor may reduce or eliminate specific line items in the Budget Act or any other appropriations bill without vetoing the entire bill. Such individual line-item vetoes are subject to override by a two-thirds majority vote of each House of the Legislature.

Appropriations also may be included in legislation other than the Budget Act. Except as noted in the previous paragraph and in the next sentence, bills containing General Fund appropriations must be approved by a two-thirds majority vote in each House of the Legislature and be signed by the Governor. Bills containing appropriations for K-12 schools or community colleges ("K-14 education") only require a simple majority vote. Continuing appropriations, available without regard to fiscal year, may also be provided by statute or the State Constitution.

Funds necessary to meet an appropriation are not required to be in the State Treasury at the time an appropriation is enacted; revenues may be appropriated in anticipation of their receipt.

Constraints on the Budget Process

Over the years, a number of laws and constitutional amendments have been enacted, often through voter initiatives, which have increased the difficulty of raising State taxes, restricted the use of the State's General Fund or special fund revenues, or otherwise limited the Legislature and the Governor's discretion in enacting budgets. Historic examples of provisions that make it more difficult to raise taxes include Proposition 13, passed in 1978, which, among other things, required that any change in State taxes enacted for the purpose of increasing revenues collected pursuant thereto, whether by increased rates or changes in computation, be approved by a two-thirds vote in each house of the Legislature. Examples of provisions restricting the use of General Fund revenues are Proposition 98, passed in 1998, which mandates that a minimum amount of General Fund revenues be spent on local education, and Proposition 10, passed in 1988, which raised taxes on tobacco products and mandated how the additional revenues would be expended. See "STATE FINANCES — Proposition 98" and "— Sources of Tax Revenue — Taxes on Tobacco Products."

More recently, a new series of Constitutional amendments sponsored by Governor Schwarzenegger and approved by the voters, have also affected the budget process. These include Proposition 58, approved in 2004, which requires the adoption of a balanced budget and restricts future borrowing to cover budget deficits, and Proposition 1A, approved in 2004, which limits the Legislature's power over local revenue sources. These, and other recent constitutional amendments affecting the budget process, are described below. In addition, the 2005–06 Governor's Budget includes budget reforms that propose new Constitutional initiatives, including an amendment that would require across-the-board spending reductions to close a budget gap if the Legislature does not act within a certain period of time. These proposals are also described below.

Proposition 58 (Balanced Budget Amendment)

Proposition 58, approved by the voters in 2004, requires the State to enact a balanced budget, establish a special reserve in the General Fund and restricts future borrowing to cover fiscal year end deficits. As a result of the provisions requiring the enactment of a balanced budget and restricting borrowing, the State would in some cases have to take more immediate actions to correct budgetary shortfalls. Beginning with the budget for fiscal year 2004–05, Proposition 58 requires the Legislature to pass a balanced budget and provides for mid-year adjustments in the event that the budget falls out of balance and the Governor calls a special session to deal with the shortfall. The balanced budget determination is made by subtracting expenditures from all available resources, including prior-year balances.

If the Governor determines that the State is facing substantial revenue shortfalls or spending increases, the Governor is authorized to declare a fiscal emergency. He or she would then be required to propose legislation to address the emergency, and call the Legislature into special session for that purpose. If the Legislature fails to pass and send to the Governor legislation to address the fiscal emergency within 45 days, the Legislature would be prohibited from: (i) acting on any other bills or (ii) adjourning in joint recess until such legislation is passed.

Proposition 58 also requires that a special reserve (the Budget Stabilization Account) be established in the State's General Fund. Beginning with fiscal year 2006–07, a specified portion of estimated annual General Fund revenues would be transferred by the Controller into the Budget Stabilization Account no later than September 30 of each fiscal year. These transfers would continue until the balance in the Budget Stabilization Account reaches $8 billion or 5 percent of the estimated General Fund revenues for that fiscal year, whichever is greater. The annual transfer requirement would be in effect whenever the balance falls below the $8 billion or 5 percent target. The annual transfers can be suspended or reduced for a fiscal year by an executive order issued by the Governor no later than June 1 of the preceding fiscal year.

Proposition 58 also prohibits certain future borrowing to cover fiscal year end deficits. This restriction applies to general obligation bonds, revenue bonds, and certain other forms of long-term borrowing. The restriction does not apply to certain other types of borrowing, such as: (i) short-term borrowing to cover cash shortfalls in the General Fund (including revenue anticipation notes or revenue anticipation warrants currently used by the State), or (ii) inter-fund borrowings.

Proposition 1A

As described under "STATE FINANCES — Local Governments" above, Senate Constitutional Amendment No. 4 (also known as "Proposition 1A"), approved by the voters in the November 2004 election, amended the State Constitution to, among other things, reduce the Legislature's authority over local government revenue sources by placing restrictions on the State's access to local governments' property, sales, and vehicle license fee revenues as of November 3, 2004. Beginning with fiscal year 2008–09, the State will be able to borrow up to 8 percent of local property tax revenues, but only if the Governor proclaims such action is necessary due to a severe State fiscal hardship and two–thirds of both houses of the Legislature approves the borrowing. The amount borrowed is required to be paid back within three years. The State also will not be able to borrow from local property tax revenues for more than 2 fiscal years within a period of 10 fiscal years. In addition, the State cannot reduce the local sales tax rate or restrict the authority of the local governments to impose or change the distribution of the statewide local sales tax.

Proposition 1A also prohibits the State from mandating activities on cities, counties or special districts without providing for the funding needed to comply with the mandates. Beginning in fiscal year 2005–06, if the State does not provide funding for the mandated activity, the requirement on cities, counties or special districts to abide by the mandate would be suspended. In addition, Proposition 1A expanded the definition of what constitutes a mandate on local governments to encompass State action that transfers to cities, counties and special districts financial responsibility for a required program for which the State previously had partial or complete responsibility. The State mandate provisions of Proposition 1A do not apply to schools or community colleges or to mandates relating to employee rights.

Proposition 49 (After School Education Funding)

An initiative statute, Proposition 49, called the "After School Education and Safety Program of 2002," was approved by the voters on November 5, 2002, and requires the State to expand funding for before and after school programs in the State's public (including charter) elementary, middle and junior high schools. In the first year after fiscal year 2003–04 that non-Proposition 98 General Fund appropriations exceed the base year level by $1.5 billion, the initiative continuously appropriates up to $550 million annually for these programs. The initiative defines the base year level as the fiscal year during the period July 1, 2000, through June 30, 2004, for which the State's non-Proposition 98 General Fund appropriations are the highest as compared to any other fiscal year during that period. Using data as of the 2005–06 Governor's Budget, the 2000–01 fiscal year is the base year. Based upon expected non-Proposition 98 General Fund appropriations as of the 2005–06 Governor's Budget, the initiative is unlikely to require implementation of the funding increase for before and after school programs until fiscal year 2007–08. The 2004 Budget Act includes approximately $121.6 million for after school programs, so when the initiative is fully triggered, it would appropriate an additional $428.4 million.

Proposition 63 (Mental Health Services)

On November 2, 2004 the voters approved Proposition 63, which imposes a 1 percent tax surcharge on taxpayers with annual taxable income of more than $1 million for purposes of funding and expanding mental health services. In addition, Proposition 63 prohibits the Legislature or the Governor from redirecting funds now used for mental health services to other purposes or from reducing General Fund support for mental health services below the levels provided in fiscal year 2003–04.

Governor's Budget Reform Proposals

As described in greater detail under "CURRENT STATE BUDGET AND GOVERNOR'S PROPOSED 2005–06 BUDGET — Governor's Budget Reform Proposals and Related Initiative," the Governor has proposed a series of Constitutional budgetary reform proposals to address the State's continuing structural deficit. These proposals include amendments (i) requiring automatic, non-discretionary across-the-board reductions in State spending to address budget imbalances if the Legislature does not act within a specified time, (ii) prohibiting the suspension of Proposition 98 guarantee payments, and eliminating the "Test 3" calculation (which allows for the reduction of the growth rate of Proposition 98 funding during low revenue years and creates a "maintenance factor" to be made up in future years); (iii) prohibiting the State from using the proceeds of the sales tax on gasoline (Proposition 42) for any purpose other than transportation projects, effective after fiscal year 2006–07; (iv) prohibiting the State from offering defined benefit plans for new employees; (v) prohibiting budgetary borrowing from special funds, even during a budget crisis; and (vi) allowing the State to repay outstanding Proposition 42 loans, deferred Proposition 98 obligations and unfunded mandates upon local governments and schools over a period of up to 15 years.

The LAO states in its report, released January 12, 2005, that these budget proposals, among other consequences, will limit the discretion of the Legislature and the Governor in dealing with budget imbalances, and potentially shift all of the burden of balancing the budget on spending reductions in non-Proposition 98 programs (such as higher education, health, social services and criminal justice) or on taxpayers in the form of higher fees and taxes. See "CURRENT STATE BUDGET AND GOVERNOR'S PROPOSED 2005–06 BUDGET — Continued 'Structural Deficit.'"

In addition, the Governor has recently endorsed a constitutional amendment initiative entitled "California Live Within Our Means Act," which is described under "CURRENT STATE BUDGET AND GOVERNOR'S PROPOSED 2005–06 BUDGET — Governor's Budget Reform Proposals and Related Initiative."

PRIOR FISCAL YEARS' BUDGETS

The California economy grew strongly between 1994 and 2000, generally outpacing the nation, and as a result, for the five fiscal years from 1995–96 to 1999–00, the General Fund tax revenues exceeded the estimates made at the time the budgets were enacted. These additional funds were largely directed to school spending as mandated by Proposition 98, to make up shortfalls from reduced federal health and welfare aid and to fund new program initiatives, including education spending above Proposition 98 minimums, tax reductions, aid to local governments and infrastructure expenditures. The State ended the 2000–2001 fiscal year with a budget reserve of $5.39 billion.

However, during fiscal year 2001–02, the State experienced an unprecedented drop in revenues compared to the prior year. The three largest tax sources generated only $59.7 billion, a drop of over $13 billion from fiscal year 2000–01, the vast bulk of which was attributable to reduced personal income taxes from stock option and capital gains activity. This revenue shortfall (as well as the temporary delay in the issuance of the DWR power revenue bonds to reimburse the State for energy purchases during the energy crisis), resulted in a substantial budgetary deficit and cash flow difficulties. Despite a mid-year spending freeze for many State agencies and spending reductions and deferrals, the State ended fiscal year 2001–02 with a $2.1 billion negative fund balance.

2002 Budget Act

The 2002–03 Governor's Budget, released on January 10, 2002 (the "2002–03 Governor's Budget") projected a combined budget gap for fiscal years 2001–02 and 2002–03 of approximately $12.5 billion due, in part, to a decline in General Fund revenues attributable to the national economic recession combined with the stock market decline. Personal income tax receipts, which include stock option and capital gains realizations, continued to be affected by the slowing economy and stock market decline. By the time the 2002 Budget Act was signed by Governor Davis on September 5, 2002, the 2002 Budget Act projected a $23.6 billion gap between expenditures and resources. The spending gap was addressed through a combination of program reductions, inter–fund borrowings, fund shifts, payment deferrals, accelerations and transfers, debt service restructuring savings and modest tax changes.

Within a few months after the 2002 Budget Act was adopted, it became evident that revenue projections incorporated in the 2002 Budget Act were substantially overstated and that certain program cost savings included in the 2002 Budget Act would not be realized.

Despite mid-year budget adjustment legislation, totaling about $10.4 billion in spending reductions, deferrals and funding transfers (including a $1.1 billion deferral of K–12 education funding into the 2003–04 fiscal year), the State's fiscal condition continued to deteriorate. The State ended fiscal year 2002–03 with a $7.5 billion negative fund balance.

2003 Budget Act

The 2003–04 Governor's Budget, released on January 10, 2003 (the "2003–04 Governor's Budget"), projected a significant downward revision in State revenues. The 2003–04 Governor's Budget projected revenues from the three largest tax sources to be about $61.7 billion in fiscal year 2002–03, more than $6 billion lower than projected in the 2002 Budget Act. The 2003–04 Governor's Budget projected total revenues and transfers of $73.1 billion and $69.2 billion in fiscal years 2002–03 and 2003–04 respectively. The 2003–04 Governor's Budget projected a $34.6 billion cumulative budget shortfall through June 30, 2004.

By the time of the Governor's May Revision, the cumulative budget shortfall estimates for fiscal years 2002–03 and 2003–04 had increased from $34.6 billion to $38.2 billion (in part due to the delay of the issuance of $2 billion tobacco securitization bonds).

The 2003 Budget Act was adopted by the Legislature on July 29, 2003, along with a number of implementing measures, and signed by Governor Davis on August 2, 2003. Under the 2003 Budget Act, General Fund revenues were projected to increase 3.3 percent, from $70.9 billion in fiscal year 2002–03 to $73.3 billion in fiscal year 2003–04.

The June 30, 2004 reserve was projected in the 2003 Budget Act to be just over $2 billion. This projection reflected the elimination of the $10.675 billion accumulated deficit through June 30, 2003 (as estimated in the 2003 Budget Act), through the issuance of long-term deficit recovery bonds (later approved as economic recovery bonds). See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS — Economic Recovery Bonds." The projection also assumed other external borrowings (including $929 million in pension bonds, which were not issued, and $2.3 billion in tobacco bonds, which were issued), as well the continued the use of Proposition 98 and other payment deferrals, inter-fund borrowings, fund shifts, accelerations and transfers to address the deficit.

The State ended fiscal year 2003–04 with a reserve of $1.7 billion.

CURRENT STATE BUDGET AND GOVERNOR'S PROPOSED 2005–06 BUDGET

The discussion below of the fiscal year 2004–05 budget and the table under "Summary of State Revenues and Expenditures" are based on estimates and projections of revenues and expenditures for the current fiscal year and must not be construed as statements of fact. These estimates and projections are based upon various assumptions, which may be affected by numerous factors, including future economic conditions in the State and the nation, and there can be no assurance that the estimates will be achieved. See "— Revenue and Expenditure Assumptions."

Background

The 2004–05 Governor's Budget, released on January 9, 2004, reported that, in the absence of corrective actions to change existing policies, operating deficits, estimated at $14 billion for fiscal 2004–05, would continue to be incurred. The May Revision released on May 13, 2004, projected a June 30, 2005 General Fund reserve of $998 million, up $363 million from the 2004–05 Governor's Budget projections. The increase in the reserve was the result of a $2.229 billion increase in prior year adjustments, a $245 million increase in revenues (over both fiscal years 2003–04 and 2004–05), a $1 billion reduction in the sale of economic recovery bonds and a $1.112 billion increase in expenditures (over both fiscal years 2003–04 and 2004–05).

2004 Budget Act

After months of negotiations between the Governor and the Legislature, the 2004 Budget Act was adopted by the Legislature on July 29, 2004, along with a number of implementing measures, and signed by the Governor on July 31, 2004. In approving the budget, the Governor vetoed $116 million in appropriations (including $80 million in General Fund appropriations). The 2004 Budget Act largely reflects the proposals contained in the May Revision, including the application for budgetary purposes of $2 billion of proceeds of the economic recovery bonds issued in fiscal year 2003–04 (see "STATE INDEBTEDNESS AND OTHER OBLIGATIONS — Economic Recovery Bonds").

Under the 2004 Budget Act, General Fund revenues were projected to increase 3.6 percent, from $74.6 billion in fiscal year 2003–04 (which included approximately $2.3 billion in additional tobacco securitization bond proceeds) to $77.3 billion in fiscal year 2004–05. The revenue projections assumed a continuing rebound in California's economy as reflected in several key indicators. See "CURRENT STATE BUDGET AND GOVERNOR'S PROPOSED 2005–06 BUDGET — Economic Assumptions." Excluding the impact of the economic recovery bonds, General Fund expenditures were estimated to increase by 6.7 percent, from $75.6 billion in fiscal year 2003–04 to $80.7 billion in fiscal year 2004–05. The June 30, 2005 reserve was projected to be $768 million, compared to an estimated June 30, 2004 reserve of $2.198 billion.

In summary, the 2004 Budget Act addressed a projected $13.9 billion budget shortfall through expenditure cuts ($4.0 billion or 28.7 percent), cost avoidance ($4.4 billion or 31.7 percent), fund shifts ($1.6 billion or 11.2 percent), loans or borrowing ($2.1 billion or 15.4 percent), and transfers and other revenue ($1.8 billion or 13.0 percent).

The 2004 Budget Act contained the following major components:

1. *Rebasing Proposition 98 Minimum Funding Guarantee*—The level of Proposition 98 appropriations was reset at a level approximately $2 billion less than would otherwise be required for fiscal year 2004–05 pursuant to legislation relating to the 2004 Budget Act. See "STATE FINANCES—Proposition 98."

2. *Higher Education*—A new fee policy for higher education was implemented whereby future undergraduate and graduate level fee increases are tied to increases in per-capita personal income, with flexibility to increase fees by not more than an average of 10 percent a year over the next three years. Under the fee policy, graduate fees may increase at rates in excess of undergraduate fees until a 50 percent differential is achieved. In fiscal year 2004–05, fees were increased 14 percent for undergraduates and 20 percent for graduate students (25 percent for CSU graduate students majoring in non-teacher preparation programs). The new long-term policy is designed to ensure that public university students are protected from future dramatic fee increases as a consequence of declines in General Fund

resources. The 2004 Budget Act included $750 million in various spending reductions for higher education from otherwise mandated levels.

3. *Health and Human Services*—While the Administration proposed major reforms of the Medi-Cal program, any such reforms were expected to take at least one year to implement. As a result, the 2004 Budget Act did not include any savings attributed to Medi-Cal redesign. Other strategies independent of the Medi-Cal redesign were included in the 2004 Budget Act, such as the implementation of Medi-Cal rate increases for County Organized Health Systems and Pharmacy Reimbursement Realignment. In addition, increased work incentives under the CalWORKs program were proposed. The budget included $992 million in reductions in various social service programs from otherwise mandated levels. Based on updated projections of caseload and cost-per-case, these savings are now estimated to be $1 billion in fiscal year 2004–05.

4. *Pension Reform*—The 2004 Budget Act eliminated State contributions to CalPERS on behalf of new State employees for the first two years of employment. In addition, the 2004 Budget Act assumed the issuance of $929 million pension obligation bonds to cover a portion of the State's required contributions to CalPERS in fiscal year 2004–05. As described below, the State no longer assumes that the pension bonds will be issued in fiscal year 2004–05 due to litigation delays. See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS — Pension Obligation Bonds."

5. *Substantially Reduced External Borrowings*—The 2004 Budget Act assumed the issuance of $929 million in pension obligation bonds to pay a portion of the pension obligations in fiscal year 2004–05. In addition, approximately $2 billion of economic recovery bond proceeds, which were deposited in the Deficit Recovery Fund, were used to offset fiscal year 2004–05 General Fund expenditures. In contrast, in fiscal year 2003–04, aggregate borrowings to address current expenses and accumulated deficits are estimated at $11.5 billion, including $2.3 billion of tobacco securitization proceeds and $9.2 billion of economic recovery proceeds (representing approximately $11.254 billion of total bond proceeds, less $2.012 billion deposited into the Deficit Recovery Fund for application in fiscal year 2004–05). See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS — Economic Recovery Bonds."

6. *Tax Relief*—The 2004 Budget Act reflects the elimination of the VLF offset program beginning in fiscal year 2004–05. See "STATE FINANCES — Local Governments."

7. *Indian Gaming*—The 2004 Budget Act included $300 million in revenues as a result of the renegotiation of tribal gaming compacts and the negotiation of new compacts with tribes that wish to expand gaming activities. As described below, the State now assumes the receipt of only $16 million in such revenues in fiscal year 2004–05. The 2004 Budget Act authorized the State to sell an additional revenue stream received from payments made by certain Indian tribes to secure up to $1.5 billion of securities, the proceeds of which will be used by the State to repay prior transportation loans. As described below, pending litigation relating to the Indian gaming compacts has delayed the issuance of these securities. See "LITIGATION—Actions Seeking to Enjoin Implementation of Certain Tribal Gaming Compacts."

8. *Other Revenue Enhancements and Expenditure Reductions*—The 2004 Budget Act also included: (i) $1.206 billion in savings for the suspension of the Transportation Investment Fund (Proposition 42) transfer; (ii) $450 million in savings from deposits of punitive damages awards used to offset General Fund costs in fiscal year 2004–05; (iii) $206 million for spending reductions that would result from changes in the correctional system; and (iv) $150 million of additional savings pursuant to Control Section 4.10 of the 2004 Budget Act (which gives the Department of Finance the authority to reduce appropriations in certain circumstances). Current budget projections for fiscal year 2004–05

assume no savings from punitive damages and only $142 million of savings from changes in the correctional system.

Proposed 2005–06 Governor's Budget

The 2005–06 Governor's Budget, released on January 10, 2005, reported that, in the absence of corrective actions to change existing policies, operating deficits, estimated at $9.1 billion in 2005–06, would continue to be incurred. The 2005–06 Governor's Budget proposes various corrective actions that result in a balanced budget as described below. The 2005–06 Governor's Budget also revises various revenue and expenditure estimates for 2004–05 as described below.

Fiscal Year 2004–05 Revised Estimates in 2005–06 Governor's Budget

The 2005–06 Governor's Budget projects that the State will end fiscal year 2004–05 with a reserve of $784 million, up approximately $16 million from estimates made at the time of the 2004 Budget Act. Under the 2005–06 Governor's Budget, General Fund revenues and transfers for 2004–05 are projected at $78.2 billion, an increase of $968 million compared with 2004 Budget Act estimates. This includes the following significant adjustments since the 2004 Budget Act:

- $1.804 billion increase in major tax revenues due to the improved economic forecast;
- $284 million loss in revenues due to delays in renegotiations of tribal gaming compacts; and
- $577 million loss in revenues due to pending litigation contesting the issuance of pension obligation bonds (bond issuance is now assumed in fiscal year 2005–06).

Under the 2005–06 Governor's Budget, General Fund expenditures for fiscal year 2004–05 are projected at $82.3 billion, an increase of $1.6 billion compared with 2004 Budget Act estimates. This includes the following significant changes since the 2004 Budget Act:

- $121 million in additional Proposition 98 expenditures;
- $450 million in additional expenditures due to the elimination of the assumption that punitive damages award revenues in this amount would be available for deposit into the General Fund;
- $150 million in additional expenditures due to the elimination of the assumption that California Performance Review reorganization savings would be realized in this amount;
- $352 million in additional expenditures due to pending litigation contesting the issuance of pension obligation bonds (This expenditure reduction assumption is now shifted to fiscal year 2005–06, assuming the issuance of pension obligation bonds);
- $157 million in additional expenditures due to enrollment and population growth;
- $101 million in additional expenditures for nursing facilities;
- $88 million in additional expenditures for increased trial courts costs; and
- $183 million in net additional expenditures for various other expenditure changes.

Budget Summaries

Set forth below is a chart showing a General Fund Budget Summary for 2004–05 as originally projected by the 2004 Budget Act, and as revised by the 2005–06 Governor's Budget, as well as a Budget Summary for fiscal year 2005–06.

FIGURE 1
2004–05 and 2005–06 General Fund Budget Summaries
(Millions)

	2004–05		2005–06
	As of 2004 Budget Act	**As of 2005–06 Governor's Budget**	**As of 2005–06 Governor's Budget**
Prior Year Resources Available	$ 3,127	$ 3,489	$ 1,425
Revenues and Transfers	77,251	78,219	83,771
Economic Recovery Bonds(1)	2,012	2,012	1,683
Expenditures	80,693	82,295	85,738
Fund Balance	$1,697	$ 1,425	$ 1,141
Reserve for Liquidation of Encumbrances	$ 929	$ 641	$ 641
Special Fund for Economic Uncertainties	$ 768	$ 784	$ 500

(1) The $2.012 billion in Economic Recovery Bonds was reflected in the 2004 Budget Act as an expenditure reduction but is shown here as a separate line item.

Proposed Fiscal Year 2005–06 Budget

The 2005–06 Governor's Budget projects to end fiscal year 2005–06 with a $500 million reserve. General Fund revenues, transfers and new Economic Recovery Bonds for fiscal year 2005–06 are projected at $85.5 billion, an increase of $5.2 billion compared with revised estimates for fiscal year 2004–05. The 2005–06 Governor's Budget, among other assumptions, reflects an increase in major revenues of $5.345 billion, or 7.0 percent, due to improved economic forecast. See "—Economic Assumptions."

General Fund expenditures for fiscal year 2005–06 are projected at $85.7 billion, an increase of $3.4 billion, or 4.2%, compared with revised estimates for fiscal year 2004–05. This reflects a total of $7.0 billion of General Fund expenditure solutions, spending reductions from the level of expenditures that would have been required to comply with the Constitution and State law, federal government mandates, court order, and to provide for cost of living adjustments and growth in enrollment, caseload, and population.

The 2005–06 Governor's Budget contains the following major components:

1. *Proposition 98*—General Fund expenditures are proposed to increase by $2.409 billion, or 7.1 percent. This reflects increases in the Proposition 98 guaranteed funding level resulting from increases in General Fund revenues in fiscal year 2005–06, adjusted for changes in local revenues. This also reflects a decision not to appropriate the $1.1 billion in 2004–05 and $1.17 billion in 2005–06 that would otherwise have been required were the Proposition 98 guarantee allowed to run next year as though the 2004–05 suspension had not occurred.

2. *Higher Education*—The 2005–06 Governor's Budget marks the first year of funding for the Higher Education Compact under this Administration. The Compact was signed in Spring 2004 with both UC and CSU to provide funding stability and preserve educational quality over the next six fiscal years in exchange for improved accountability in a variety of key student performance measures.

3. *Health and Human Services*—The 2005–06 Governor's Budget proposes to increase expenditures by $1.2 billion over revised 2004–05 levels for Health and Human Services Programs. This increase consists of caseload and other workload increases totaling $2.3 billion, offset by $1.2 billion in savings from major policy changes to close the budget gap. Approximately $903 million of savings are projected to be achieved through Department of Social Services proposals, including several CalWORKS reductions ($449 million), a reduction in State participation in IHSS Wages/Health Benefits ($195 million), and the suspension of the January 2006 SSI/SSP State Cost-of-Living Adjustments and the withholding of the pass-through of the January 2006 federal Cost-of-Living Adjustments ($259 million). In addition, Medi-Cal savings of $260 million is projected to be achieved primarily by replacing General Fund support with new federal funds for certain prenatal care services.

4. *Pension Initiatives*—The 2005–06 Governor's Budget includes reduced expenditures from proposed changes to the pension system. These include a projected $296 million of savings from two proposals: (i) all state employees, as their contracts expire, will be required to fund one-half of the future cost of retirement rather than approximately one-fourth of the amounts, and (ii) state employees will be allowed to opt out of CalPERS, and the State would augment their salaries by one-half the actuarial normal cost. The achievement of these savings is subject to collective bargaining negotiations. The reforms also include a projected $469 million of CalSTRS savings achieved by shifting the State's contribution to the Defined Benefit Program to the school districts or the covered employees. The 2005–06 Governor's Budget also assumes the issuance of pension obligation bonds as described below.

5. *External Borrowings*—The 2005-06 Governor's Budget assumes the issuance of $800 million pension obligation bonds, yielding a net benefit to the General Fund of $765 million, to cover a portion of the State's required contributions to CalPERS in fiscal year 2005–06. Of the $765 million, $600 million is reflected as a revenue transfer and $165 million as savings. The 2005–06 Governor's Budget assumes no pension obligation bonds proceeds for fiscal year 2004–05. The 2005–06 Governor's Budget also anticipates the issuance of $1.683 billion of additional economic recovery bonds for use in fiscal year 2005–06. This represents a reduction from the approximately $2 billion of economic recovery bond proceeds which were included in the 2004 Budget Act. (After issuance of the $1.683 billion of economic recovery bonds, approximately $2 billion of additional economic recovery bonds will remain authorized but unissued.). See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS—Economic Recovery Bonds." In addition, the 2005–06 Governor's Budget anticipates the issuance of $464 million judgment bonds to finance a pending settlement of the *Paterno* lawsuit. See "LITIGATION — Actions Seeking Flood Related Damages." The State has never issued judgment bonds and there can be no assurance that litigation, if any, will not delay the issuance. See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS."

6. *Other Revenue Enhancements and Expenditure Reductions*—The 2005–06 Governor's Budget includes: (i) $1.3 billion in savings for the suspension of the Transportation Investment Fund (Proposition 42) transfer; (ii) $250 million in savings from the suspension of most mandates in 2005–06; (iii) $409 million from a variety of proposals to increase revenues without tax increases; and (iv) $150 million in additional savings from reducing state operations budgets for departments within the Administration.

California Performance Review

As a result of recommendations by the California Performance Review, the Governor submitted two reform proposals to the Little Hoover Commission on January 6, 2005. The first proposal would eliminate 88 boards and commissions, thereby removing unnecessary layers of bureaucracy and improving constituent accessibility. The second proposal would reorganize the Youth and Adult Correctional Agency into the Corrections and Rehabilitation Department by removing duplicative functions and consolidating management authority. The 2005–06 Governor's Budget assumes no savings from these proposals for fiscal years 2004–05 and 2005–06.

Governor's Budget Reform Proposals and Related Initiative

Although the 2005–06 Governor's Budget makes significant progress in eliminating the structural deficit, absent corrective action, the State will continue to face a structural budget deficit in fiscal year 2006–07 and beyond. The 2005–06 Governor's Budget proposes a series of constitutional reforms to create the tools and incentives needed to return California's budget to true structural balance. These proposed constitutional amendments have been submitted to the Legislature in a special session called by the Governor, and must be approved by a majority of the voters. The Administration is still working with the Legislature towards the adoption of the proposed budget reforms. The Governor, however, has indicated that he will present the proposed constitutional amendments directly to the electorate through the initiative process if the Legislature fails to approve the proposed reforms in time for a special election.

To that end, the Governor recently endorsed the budget reform initiative titled "California Live Within Our Means Act," which contains provisions similar, but not identical, to the Governor's constitutional budget reform proposals. This initiative, which is also briefly summarized below, has been approved by the Attorney General for circulation to the voters. In order to qualify for any November 2005 special election called by the Governor, the sponsors of the initiative must obtain approximately 600,000 signatures and qualify the initiative on or before June 30, 2005. The Governor has not yet called for a special election to be held in November 2005.

Governor's Budget Reform Proposals

The Governor's reforms are described below:

Budget Control Proposals

1. *Across-the-Board Reductions*—Whenever the Director of Finance advises the Governor that State spending is at a level that is likely to exceed available revenue, the Budget Control Proposal would require the Governor to call a special session to address the imbalance. If the Legislature and the Governor fail to address the budget imbalance within 45 days of the calling of the special session, the State Controller would be required to implement an across-the-board reduction in all State General Fund payments (except for debt service and any reduction that would violate the Constitution). Further, the proposed reform would provide that whenever the State does not have a budget in effect at the beginning of the fiscal year (July 1), the appropriation levels in the previous year's budget would remain in effect until such time as the Legislature and the Governor enact a new budget. In this case, an across-the-board reduction in all State General Fund payments will be made within 30 days to keep within existing resources.

2. *Proposition 98 Reform*—Currently, the Legislature can suspend the Proposition 98 guarantee with a bill approved by two-thirds of each house. Suspension of the Proposition 98 guarantee creates a maintenance factor of the same amount. The Proposition 98 reform proposal eliminates the

Legislature's ability to suspend Proposition 98 and the Test 3 calculation that allows the State to reduce Proposition 98 payments when the sum of percentage growth in per capita General Fund revenues plus 0.5 percent is lower than percentage growth in per capita personal income, and also creates a maintenance factor. By eliminating suspension of Proposition 98 and the Test 3 calculation, no new maintenance factor will be created in future years. All sums owed for the maintenance factor existing as of June 30, 2006, will be repaid on a one-time basis within 15 years.

Under this reform proposal, the State will annually pay its Proposition 98 obligation to K–14 education as specified by the original two tests, whichever is applicable, unless General Fund appropriations are reduced pursuant to the across-the-board reduction. The State will not postpone Proposition 98 obligations to future years and settle-up obligations, which are one-time in nature, owed for prior fiscal years through and including the 2003–04 fiscal year will be repaid within 15 years of the effective date that the measure is approved by the voters implementing this proposal. The Proposition 98 reform proposal also requires certification of the Proposition 98 guarantee by the Department of Finance and the Superintendent of Public Instruction within 24 months following the end of each fiscal year beginning with the 2004–05 fiscal year, and will continuously appropriate any settle-up funds owed for each of those years as soon as each fiscal year's obligation is certified.

3. *Proposition 42 Reform*—Proposition 42, enacted by the voters in 2002, requires the State to use the proceeds of the sales tax on gasoline only for transportation projects. However, since its enactment, Proposition 42 has been suspended once and partially suspended a second time. The Proposition 42 reform proposal allows the State to suspend Proposition 42 for two more fiscal years (2005–06 and 2006–07), but removes from the Constitution the ability to suspend after that. All Proposition 42 transfers that are suspended will be treated as loans to the General Fund and will be repaid within a period of up to 15 years.

4. *Special Funds Reform*—This proposal prohibits budget borrowing from special funds, even during a budget crisis.

5. *Consolidation of Inter-fund Borrowings*—Selected amounts owed by the State to the following accounts will be proposed for repayment over a period of up to 15 years: (i) Proposition 42 loans, estimated at $4.8 billion; (ii) Maintenance Factor and accumulated Settle-up under Proposition 98, estimated at $4.9 billion; (iii) Unfunded mandates upon local governments, estimated at $1.5 billion; and (iv) Unfunded mandates through fiscal year 2003–04 upon schools (from Proposition 98 funds), estimated at $1.2 billion.

Pension Reform

The Pension Reform proposal will amend the Constitution to prohibit the State or any of its political subdivisions from offering defined benefit plans to new employees. Further, it proposes that the State bargain with employee unions to equalize the employee and employer share of the annual contribution to CalPERS as labor contracts come due, for an anticipated General Fund savings of $206 million in fiscal year 2005–06.

"California Live Within Our Means Act" Initiative

This initiative, which the Governor has endorsed, resembles the Governor's budget reform proposals in many respects, including constitutional reforms related to Proposition 98 (although, unlike the Governor's proposal, the initiative would not eliminate the Legislature's ability to suspend Proposition 98), the elimination of the State's ability to borrow from special funds except for cashflow short term borrowing, and the repayment of existing inter-fund borrowings and mandates. The initiative, however, expands upon the Governor's expenditure reform proposals in certain significant ways. The initiative would amend the Constitution to limit the annual growth in State spending to the average annual growth in General Fund and special fund revenues for the prior three fiscal years. This limit on spending would be in addition to the Appropriations Limit imposed by Article XIII B of the Constitution. Any revenues collected in excess of this limitation and allocated to the General Fund would be dedicated to specified purposes, including (i) the funding of the Budget Stabilization Account created under Proposition 58, (ii) the retirement of outstanding Proposition 98 mandates and economic recovery bonds, and the funding of the previous suspensions of transfer to the State transportation funds, and (iii) the construction of school and highway infrastructure. Funds allocated for these purposes would not be counted for purposes of calculating the following year's spending limit.

The initiative would also amend the Constitution to authorize the Governor to address budget shortfalls during any fiscal year, not otherwise addressed by the Legislature within the time parameters set forth in the initiative, in any manner the Governor deems appropriate (whether proportionately or disproportionately), but subject to certain priority payments (including the payment of debt service, payments required by federal law, and payments under contracts incurred prior to the enactment of the initiative). The initiative also provides that if a budget is not adopted in any year by July 1, then the budget appropriation levels for the prior year would remain in effect until the new budget is adopted.

Full text of this initiative is available on the Attorney General's website at www.caag.state.ca.us/initiatives/activeindex.htm.

Continued "Structural Deficit"

On January 12, 2005 the LAO released its report entitled "2005–06: Overview of the Governor's Budget" (the "January Report"), which contained the LAO's initial analysis of the 2005-06 Governor's Budget. In the January Report, the LAO stated that the 2005-06 Governor's Budget has several "positive attributes" and "realistically portrays the size of the [budget] problem facing the state and contains reasonable estimates for its solution." Among the "positive attributes" cited by the LAO included the use of only a portion of the remaining authorized economic recovery bonds (leaving $2 billion of authorization to future years), not increasing current year Proposition 98 funding, and relying on "reasonable estimates of caseloads, costs and revenues." The LAO stated that the 2005-06 Governor's Budget, assuming all budget saving proposals are adopted and fully achieved, would reduce the State's structural shortfall by about one-half (or $4.5 to $5 billion annually), but that the State will "continue to face major budget imbalances in fiscal year 2006–07 and beyond, absent additional corrective measures."

On February 22, 2005 the LAO released its report entitled "The 2005-06 Budget: Perspectives and Issues" (the "February Report"), which contained a more expansive analysis of the 2005-06 Governor's Budget, as well as an analysis of related major policy issues facing the Legislature. In the February Report, the LAO, taking into account the 2004 year-end corporate and personal income tax payments, which exceeded the 2005-06 Governor's Budget forecasts by $800 million, significantly increased its projection of the State's revenues. The LAO projected that revenues would exceed the 2005-06 Governor's Budget forecast by $1.4 billion in the current fiscal year, and by $800 million in fiscal year 2005-06. Based upon these increased revenue projections, and assuming all of the budget proposals from the 2005-06 Governor's Budget are adopted and nearly all of its savings realized, the LAO projects that the State will end fiscal year 2005-06 with a general reserve of $2.9 billion, or $2.4 billion more than that assumed in the 2005-06 Governor's Budget estimate of $500 million.

In its reports the LAO warned that some of the savings in the 2005–06 Governor's Budget are subject to considerable risk, including particularly the assumed sale of $800 million (yielding net proceeds of $765 million) of pension obligation bonds, which is subject to court challenge, $408 million of public employee compensation savings which are dependent on collective bargaining negotiations, and savings from unallocated reductions in state operations in most program areas and procurement reforms, which have often fallen short of expected levels of savings in prior years. The LAO also highlights other factors that would perpetuate the State's structural deficit, such as the use of $1.7 billion of economic recovery bond proceeds and $765 million of pension bond proceeds in the 2005-06 budget, and the end, in fiscal year 2006-07, of the two year diversion of local property taxes under Proposition 1A. In the February Report the LAO continues to warn of State budget shortfalls in the range of $4 to 4.5 billion, assuming that all of the budget proposals from the 2005-06 Governor's Budget (or alternative proposals of equal magnitude) are adopted, or of budget deficits in the range of twice that magnitude if such budget proposals (or alternative proposals of equal magnitude) are not adopted.

The LAO reports also raise concerns relating to the Governor's structural reform proposals. The LAO warns that the Proposition 98 and across-the-board reduction provisions "would dramatically reduce the ability of future policy makers to establish budget priorities." In particular, the LAO cautions that the elimination of the Proposition 98 suspension provisions and Test 3 calculation (which allows for the reduction of the growth rate of Proposition 98 funding during low revenue years) would leave policy makers with limited discretion over the allocation of budget resources between education and other state programs, and potentially shift all of the burden of balancing the budget on spending reductions in non-Proposition 98 programs (such as higher education, health, social services and criminal justice), or on taxpayers in the form of higher fees and taxes. In the LAO's view, the elimination of the ability to suspend Proposition 42 transfers for transportation or to borrow from special funds would also limit the State's ability to deal with budget shortfalls.

Publications from the LAO can be read in full by accessing the LAO's website (www.lao.ca.gov) or by contacting the LAO at (916) 445-4656.

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Summary of State Revenues and Expenditures

The table below presents the actual revenues, expenditures and changes in fund balance for the General Fund for fiscal years 2001–02, 2002–03, and 2003–04, estimated results for fiscal year 2004–05 and projected results (based upon the 2005–06 Governor's Budget) for fiscal year 2005–06.

TABLE 11
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE–GENERAL FUND
(Budgetary Basis)[(a)]
FISCAL YEARS 2001–02 THROUGH 2005–06
(Millions)

	2001–02	2002–03	2003–04	Estimated[(b)] 2004–05[(c)]	Proposed[(b)] 2005–06[(c)]
Fund Balance–Beginning of Period	$ 9,017.5	$ (2,109.8)	$ (7,536.2)	$ 3,309.4	$ 1,424.9
Restatements					
Prior Year Revenue, Transfer Accrual Adjustments[(d)]	(729.8)	154.4	2,626.1	(212.1)	–
Prior Year Expenditure, Accrual Adjustments	217.4	374.2	512.7	391.5	–
Fund Balance–Beginning of Period, as Restated	$ 8,505.1	$ (1,581.2)	$ (4,397.4)	$ 3,488.8	$ 1,424.9
Revenues	$ 64,060.3	$68,545.8	$74,149.8	$77,903.9	$83,227.5
Other Financing Sources					
Economic Recovery Bonds[(e)]	–	–	11,254.0	–	1,682.8
Transfers from Other Funds	2,143.3	3,289.5	914.8	315.2	544.0
Other Additions	33.9	143.9	124.9	–	–
Total Revenues and Other Sources	$ 66,237.5	$71,979.2	$86,443.5	$78,219.1	$85,454.3
Expenditures					
State Operations	$ 19,085.7	$18,277.6	$19,498.2	$19,833.5	$20,354.4
Local Assistance	57,142.0	59,145.3	58,610.8	62,384.5	65,309.3
Capital Outlay	323.5	141.3	348.7	77.0	74.1
Unclassified	–	–	–	(2,012.0)[(f)]	–
Other Uses					
Transfer to Other Funds	301.2	370.0	279.0	–[(g)]	–[(g)]
Total Expenditures and Other Uses	$ 76,852.4	$ 77,934.2	$78,736.7	$80,283.0	$85,737.8
Revenues and Other Sources Over or (Under) Expenditures and Other Uses	$(10,614.9)	$ (5,955.0)	$ 7,706.8	$(2,063.9)	$ (283.5)
Fund Balance					
Reserved for Encumbrances	$ 1,491.5	$ 1,037.4	$ 641.4	$ 641.5	$ 641.5
Reserved for Unencumbered Balances of Continuing Appropriations[(h)]	827.3	996.9	902.1	451.5	112.9
Unreserved–Undesignated [(i)]	(4,428.6)	(9,570.5)	1,765.9	331.9	387.0
Fund Balance–End of Period	$ (2,109.8)	$ (7,536.2)	$ 3,309.4	$1,424.9	$ 1,141.5

Footnotes on following page.

Source: Fiscal years 2000–01 to 2003–04: State of California, Office of the State Controller.
Fiscal years 2004–05 and 2005–06: State of California, Department of Finance.

(a) These statements have been prepared on a budgetary basis in accordance with State law and some modifications would be necessary in order to comply with generally accepted accounting principles ("GAAP"). The Supplementary Information contained in the State's Audited Annual Financial Statements for the year ended June 30, 2004, incorporated by reference in this APPENDIX A, contains a description of the differences between the budgetary basis and the GAAP basis of accounting and a reconciliation of the June 30, 2002 fund balance between the two methods.

(b) Estimates are shown net of reimbursements and abatements.

(c) Estimated as of the 2005–06 Governor's Budget, January 10, 2005.

(d) Figure for fiscal year 2003–04 is higher due to a change in account for prior year revenues collected by the Franchise Tax Board ("FTB") for the Voluntary Compliance Initiative revenue. FTB now recognizes audit findings as prior year revenue collected.

(e) Reflects the issuance of economic recovery bonds sufficient to provide net proceeds to the General Fund of $11.254 billion in 2003–04 to finance the negative General Fund reserve balance as of June 30, 2004, and other General Fund obligations undertaken prior to June 30, 2004. See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS — Economic Recovery Bonds." $2.012 billion of this amount is budgeted as an expenditure reduction in fiscal year 2004–05.

(f) Reflects General Fund payment offsets from moneys deposited in the Deficit Recovery Fund ($2.012 billion).

(g) "Transfer to Other Funds" is included either in the expenditure totals detailed above or as "Transfer from Other Funds."

(h) For purposes of determining whether the General Fund budget, in any given fiscal year, is in a surplus or deficit condition, see Chapter 1238, Statutes of 1990, amended Government Code Section 13307. As part of the amendment, the unencumbered balances of continuing appropriations which exist when no commitment for an expenditure is made should be an item of disclosure, but the amount shall not be deducted from the fund balance. Accordingly, the General Fund condition included in the 2005–06 Governor's Budget includes the unencumbered balances of continuing appropriations as a footnote to the statement ($1,052.0 million in fiscal year 2003–04, $451.5 million in fiscal year 2004–05, and $112.9 million in fiscal year 2005–06). However, in accordance with Government Code Section 12460, the State's Budgetary/Legal Basis Annual Report reflects a specific reserve for the encumbered balance for continuing appropriations.

(i) Includes Special Fund for Economic Uncertainties ("SFEU"). The Department of Finance generally includes in its estimates of the SFEU and set aside reserves, if any, the items reported in the table under "Reserved for Unencumbered Balances of Continuing Appropriations," and "Unreserved — Undesignated." The Department of Finance estimates a $783 million SFEU balance on June 30, 2005, and projects a $500 million SFEU balance on June 30, 2006, based upon the 2005–06 Governor's Budget released on January 10, 2005.

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Revenue and Expenditure Assumptions

The table below presents the Department of Finance's budget basis statements of major General Fund revenue sources and expenditures for the 2003–04 fiscal year and the 2005–06 Governor's Budget estimates for the 2004–05 and 2005–06 fiscal years.

TABLE 12
Major General Fund Revenue Sources and Expenditures

	Revenues (Millions)			
	Fiscal Years			
Source	**2003–04[a] Actual**	**2004–05[b] Enacted**	**2004–05[c] Revised**	**2005–06[c] Proposed**
Personal Income Tax	$36,399	$38,974	$39,527	$42,895
Sales and Use Tax	23,847	25,146	25,168	26,947
Corporation Tax[d]	6,926	7,573	8,678	9,015
Insurance Tax	2,115	2,195	2,230	2,300
Economic Recovery Bonds[e]	–	2,012	2,012	1,683
All Other	5,475[f]	3,363[g]	2,616[h]	2,614[i]
Total Revenues and Transfers	$74,762	$79,263	$80,231	$85,454

	Expenditures (Millions)			
	Fiscal Years			
Function	**2003–04[a] Actual**	**2004–05[b] Enacted**	**2004–05[c] Revised**	**2005–06[c] Proposed**
K-12 Education	$29,333	$34,049	$34,435	$35,884
Health and Human Services	22,762	25,467	25,543	26,708
Higher Education	8,780	9,360	9,363	10,042
Youth and Adult Correctional	5,389	6,392	6,933	7,014
Legislative, Judicial and Executive	2,544	2,730	2,873	3,016
Tax Relief	3,782[j]	668[k]	668[l]	539
Resources	950	1,020	1,067	1,270
State and Consumer Services	462	514	535	563
Business, Transportation and Housing	499	377	377	380
All Other	1,832	116[l]	501[m]	322[n]
Total Expenditures	$76,333	$80,693	$82,295	$85,738

Footnotes continue on following page.

Source: State of California, Department of Finance. Figures in this table may differ from the figures in Table 4; see "Note" to Table 4.

(a) Figures for fiscal year 2003–04, prepared by the Department of Finance, are slightly different than the figures in Table 11, prepared by the State Controller's Office, because of certain differences in accounting methods used by the two offices.

(b) 2004 Budget Act, July 31, 2004.

(c) 2005–06 Governor's Budget, January 10, 2005.

(d) Reflects the Administration's expectations regarding the effect of the court's decision in *Farmer Brothers Company v. Franchise Tax Board* (California Court of Appeal, Second District, Case No. B160061). A $465 million negative prior year adjustment is included in the 2004 Budget Act.

(e) Reflects the Administration's issuance of economic recovery bonds sufficient to provide $11.254 billion net proceeds to the General Fund in fiscal year 2003–04 (issued on May 11, 2004 and June 16, 2004). See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS— Economic Recovery Bonds." For budgeting purposes, $9.242 billion of this amount was applied to fiscal year 2002–03, and $2.012 billion of this amount was budged as an expenditure reduction for fiscal year 2004–05. For purposes of this table, the $2.012 billion is included in General Fund resources to provide better comparability. Proceeds from the Economic Recovery Bonds and transfers to the Deficit Recovery Fund are not shown in this table in the 2003–04 fiscal year.

(f) Includes $2.264 billion for tobacco securitization bond proceeds. See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS — Tobacco Settlement Revenue Bonds."

(g) Includes $300 million from Indian gaming revenues and $577 million from pension obligation bonds.

(h) Includes $16 million from Indian gaming revenues and $0 from pension obligation bonds. Pension obligation bonds are expected to be sold in fiscal year 2005–06.

(i) Includes $34 million from Indian gaming revenues and $600 million from pension obligation bonds.

(j) Reflects the suspension of VLF "backfill" payments to local governments, which was rescinded on November 17, 2003. See "STATE FINANCES — Local Governments."

(k) Reflects the elimination of VLF "backfill" payments to local governments.

(l) Reflects General Fund payment offsets from moneys deposited in the Public Benefit Trust Fund from punitive damages awards ($450 million). For purposes of this table, the $2.012 billion from the Economic Recovery Bonds is shown in General Fund resources rather than as an expenditure reduction.

(m) Reflects $0 to the Public Benefit Trust Fund from punitive damages awards. For purposes of this table, the $2.012 billion from the Economic Recovery Bonds is shown in General Fund resources rather than as an expenditure reduction.

(n) Reflects reduced expenditures of $165 million due to the anticipated receipt of pension obligation bond proceeds to cover General Fund contributions to pension funds.

Development of Revenue Estimates

The development of the forecast for the major General Fund revenues begins with a forecast of national economic activity prepared by an independent economic forecasting firm. The Department of Finance's Economic Research Unit, under the direction of the Chief Economist, adjusts the national forecast based on the Department's economic outlook. The national economic forecast is used to develop a forecast of similar indicators for California activity.

After finalizing the forecasts of major national and California economic indicators, revenue estimates are generated using revenue forecasting models developed and maintained by the Department of Finance. With each forecast, adjustments are made for any legislative, judicial, or administrative changes, as well as for recent cash results. The forecast is updated twice a year and released with the Governor's Budget by January 10 and the May Revision by May 14.

Economic Assumptions

The revenue and expenditure assumptions set forth above have been based upon certain estimates of the performance of the California and national economies in calendar years 2005 and 2006. In the 2005–06 Governor's Budget, the Department of Finance projected that the California economy would grow at a rate close to the long-run average growth of the State economy in calendar years 2005 and 2006.

Both the California economy and the national economy improved in 2004. Growth of national economic output was close to a 20-year high. California personal income grew more than twice as fast in the first three quarters of 2004 than in the same period of 2003. In addition, state taxable sales growth improved, made-in-California exports rebounded, and State job growth picked up.

California total personal income was 5.7 percent higher in the first three quarters of 2004 than in the same quarters of 2003; the corresponding gain a year earlier was 2.6 percent. The corresponding gains for wage and salary income were 5.2 percent and 2.1 percent. Statewide taxable sales were 6.1 percent higher in the first half of 2004 than in the first half of 2003; a year earlier the gain was 3.3 percent. California exports were 20 percent higher in the first three quarters of 2004 than a year earlier. Exports of computer and electronic products, transportation equipment, and machinery (except electrical) accounted for over three-quarters of the gain in total exports. Total State exports fell by 26 percent in the preceding three years. From December 2003 to December 2004, nonfarm payroll employment was higher than a year earlier by 1.1 percent in California and 1.7 percent in the nation. In both the State and the nation, job growth was below long-run average job growth but better than a year earlier when employment was down 0.4 percent in the State and 0.3 in the nation. The State unemployment was 5.8 percent in December 2004, down from 6.5 percent in December 2003. Over the same period, the national unemployment fell from 5.7 percent to 5.4 percent.

Construction rose again in the State in 2004. Total new residential units permitted were up 6.6 percent in the first 11 months of 2004 from the same months in 2003. Over the same period, the valuation of private nonresidential building permits rose by 12.4 percent.

Home sales were up 4.1 percent and median prices were up 20.9 percent in the state in the first 11 months. Most of the sales gain was in the first half of the year when sales were up 9.8 percent. During the July-to-November period, sales were off by 1.6 percent compared to the same five-month period a year earlier.

The 2005-06 Governor's Budget projects U.S. output growth to slow somewhat, but wage and salary and personal income growth will pick up slightly. California is expected to track the national economy on these measures.

The Department of Finance sets out the following estimates for the State's economic performance in calendar years 2005 and 2006, which were used in predicting revenues and expenditures for the 2005–06 Governor's Budget. Also shown is the Department of Finance's previous forecast for the same calendar years, which were contained in the 2004–05 May Revision.

TABLE 13
ESTIMATES OF STATE'S ECONOMIC PERFORMANCE

	For Calendar Year 2005		For Calendar Year 2006	
	2005–06 Governor's Budget[(a)]	2004–05 May Revision[(b)]	2005–06 Governor's Budget[(a)]	2004–05 May Revision[(b)]
Non-farm wage and salary employment (000)	14,824	14,832	15,087	15,245
Percent Change	1.8%	2.1%	1.8%	2.8%
Personal income ($ billions)	$1,324	$1,333	$1,404	$1,424
Percent Change	5.8%	5.6%	6.0%	6.8%
Housing Permits (Units 000)	199	200	195	213
Consumer Price Index (percent change)	2.9%	2.3%	2.5%	2.3%

(a) Fiscal Year 2005–06 Governor's Budget Summary: January 10, 2005.

(b) 2004–05 May Revision, May 13, 2004.

Source: State of California, Department of Finance.

FINANCIAL STATEMENTS

The Audited Annual Financial Statements of the State of California for the Year Ended June 30, 2004 (the "Financial Statements") are available. As of June 30, 2002, the State of California has implemented a new financial reporting model, as required by the Governmental Accounting Standards Board ("GASB") in conformity with accounting principles generally accepted in the United States of America. The GASB sets standards of accounting and financial reporting for state and local governments, which have significantly changed the presentation of the financial statements. The Financial Statements consists of an Independent Auditor's Report, a Management Discussion and Analysis, Basic Financial Statements of the State for the Year Ended June 30, 2004 ("Basic Financial Statements"), and Supplementary Information. Only the Basic Financial Statements have been audited, as described in the Independent Auditor's Report. A description of the new accounting and financial reporting standards is contained in Note 1 of the Basic Financial Statements.

Potential investors may obtain or review a copy of the Financial Statements from the following sources:

1. By obtaining, from any Nationally Recognized Municipal Securities Information Repository, or any other source, a copy of the State of California's Official Statement dated March 29, 2005, relating to the issuance of $218,380,000 State Public Works Board Lease Revenue Bonds (Department of General Services) 2005 Series A (Butterfield State Office Complex) and $51,900,000 of State Public Works Board Lease Revenue Bonds (Department of Health Services) 2005 Series B (Richmond Laboratory, Phase III Office Building). The Financial Statements are printed in full in such Official Statement. No part of the March 29, 2005 Official Statement is incorporated into this document except the Financial Statements.

2. By accessing the internet website of the State Controller (www.sco.ca.gov) and selecting "California Government — State and Local," then "State Government," then finding the heading "Publications" and selecting "Comprehensive Annual Financial Report — Year Ended June 30, 2004," or by contacting the Office of the State Controller at (916) 445-2636.

3. By accessing the internet website of the State Treasurer (www.treasurer.ca.gov) and selecting "Financial Information" and then "Audited General Purpose Financial Statements," or by contacting the Office of the State Treasurer at (800) 900-3873.

The State Controller's unaudited report of cash receipts and disbursements for the period of July 1, 2004 through March 31, 2005 is also included as an Exhibit to this APPENDIX A and is available on the State Controller's website.

Periodic reports on revenues and/or expenditures during the fiscal year are issued by the Administration, the State Controller's Office and the Legislative Analyst's Office. The State Controller issues a monthly report on cash receipts and disbursements recorded on the Controller's records. The Department of Finance issues a monthly bulletin, available by accessing the internet website of the Department of Finance (www.dof.ca.gov), which reports the most recent revenue receipts as reported by State departments, comparing those receipts to budget projections. The Administration also formally updates its budget projections three times during each fiscal year, in January, May, and at the time of budget enactment. These bulletins and reports are available on the internet at websites maintained by the agencies and by contacting the agencies at their offices in Sacramento, California. Such bulletins and reports are not part of or incorporated into the Official Statement. Investors are cautioned that interim financial information is not necessarily indicative of results for a fiscal year. Information which may appear in the Official Statement from the Department of Finance concerning monthly receipts of "agency cash" may differ from the State Controller's reports of cash receipts for the same periods because of timing differences in the recording of in-transit items.

OVERVIEW OF STATE GOVERNMENT

Organization of State Government

The State Constitution provides for three separate branches of government: the legislative, the judicial and the executive. The Constitution guarantees the electorate the right to make basic decisions, including amending the Constitution and local government charters. In addition, the State voters may directly influence State government through the initiative, referendum and recall processes.

California's Legislature consists of a forty-member Senate and an eighty-member Assembly. Assembly members are elected for two-year terms, and Senators are elected for four-year terms. Assembly members are limited to three terms in office and Senators to two terms. The Legislature meets almost year round for a two-year session. The Legislature employs the Legislative Analyst, who provides reports on State finances, among other subjects. The Bureau of State Audits, headed by the State Auditor, an independent office since 1993, annually issues an auditor's report based on an examination of the General Purpose Financial Statements of the State Controller, in accordance with generally accepted accounting principles. See "FINANCIAL STATEMENTS."

The Governor is the chief executive officer of the State and is elected for a four-year term. The Governor presents the annual budget and traditionally presents an annual package of bills constituting a legislative program. In addition to the Governor, State law provides for seven other statewide elected officials in the executive branch. The current elected statewide officials, their party affiliation and the dates on which they were first elected are as follows:

Office	Name	Party Affiliation	First Elected
Governor	Arnold Schwarzenegger	Republican	2003
Lieutenant Governor	Cruz Bustamante	Democrat	1998
Controller	Steve Westly	Democrat	2002
Treasurer	Philip Angelides	Democrat	1998
Attorney General	Bill Lockyer	Democrat	1998
Secretary of State	Bruce McPherson[a]	Republican	-
Superintendent of Public Instruction	Jack O'Connell	Democrat	2002
Insurance Commissioner	John Garamendi	Democrat	2002

(a) Confirmed by the Legislature and sworn in as Secretary of State on March 30, 2005.

The current term for each office expires in January 2007. Persons elected to statewide offices are limited to two terms in office (eight years) from the dates shown above. Mr. Garamendi previously served as elected Insurance Commissioner before term limits were enacted. Governor Schwarzenegger may seek re-election in 2006 to one term.

The executive branch is principally administered through eleven major agencies and departments: Business, Transportation and Housing Agency, Child Development and Education Agency, Environmental Protection Agency, Department of Finance, Department of Food and Agriculture, Health and Human Services Agency, Labor and Workforce Development Agency, Resources Agency, State and Consumer Services Agency, Department of Veterans Affairs and Youth and Adult Correctional Agency. In addition, some State programs are administered by boards and commissions, such as The Regents of the University of California, Public Utilities Commission, Franchise Tax Board and California Transportation Commission, which have authority over certain functions of State government with the power to establish policy and promulgate regulations. The appointment of members of boards and commissions is usually shared by the Legislature and the Governor, and often includes ex officio members.

California has a comprehensive system of public higher education comprised of three segments: the University of California, the California State University System and California Community Colleges. The University of California provides undergraduate, graduate and professional degrees to students. Approximately 51,800 degrees were awarded in the 2003–04 school year. Approximately 202,900 full-time students are expected to be enrolled at the nine UC campuses and the Hastings College of Law in the 2004–05 school year. The California State University System provides undergraduate and graduate degrees to students. Approximately 82,600 degrees were awarded in the 2003–04 school year. About 34,120 full-time students are expected to be enrolled at the 23 campuses in the 2004–05 school year. The third sector consists of 109 campuses operated by 72 community college districts, which provide associate degrees and certificates to students. Additionally students may attend community colleges to meet basic skills and other general education requirements prior to transferring to a four-year undergraduate institution. Approximately 117,000 associate degrees and certificates were awarded in the 2003–04 school year. About 1.6 million students were enrolled in California's community colleges in the spring of 2004.

Employee Relations

In 2005–06, the State work force is comprised of approximately 318,000 positions, of which approximately 116,000 positions represent employees of institutions of higher education. Of the remaining 202,000 positions, approximately 166,000 are subject to collective bargaining and approximately 36,000 are excluded from collective bargaining. State law provides that State employees, defined as any civil service employee of the State and teachers under the jurisdiction of the Department of Education or the Superintendent of Public Instruction, and excluding certain other categories, have a right to form, join, and participate in the activities of employee organizations for the purpose of representation on all matters of employer-employee relations. The chosen employee organization has the right to represent its members, except that once an employee organization is recognized as the exclusive representative of a bargaining unit, only that organization may represent employees in that unit.

The scope of representation is limited to wages, hours, and other terms and conditions of employment. Representatives of the Governor are required to meet and confer in good faith and endeavor to reach agreement with the employee organization, and, if agreement is reached, to prepare a memorandum of understanding and present it to the Legislature for ratification. The Governor and the recognized employee organization are authorized to agree mutually on the appointment of a mediator for the purpose of settling any disputes between the parties, or either party could request the Public Employment Relations Board to appoint a mediator.

There are twenty-one collective bargaining units that represent state employees. Seven bargaining unit contracts expire in June 2005, five expire in June 2006, one expires in July 2006, and two expire in June 2008. For the remaining six units, comprising approximately 15 percent of the State workforce, that do not have a signed contract; the terms of the prior agreements remain in effect. The Department of Personnel Administration is continuing to negotiate with these units. The State has not experienced a major work stoppage since 1972. The California State Employees' Association is the exclusive representative for nine of the twenty-one collective bargaining units, or approximately 50 percent of those represented employees subject to collective bargaining. Each of the remaining exclusive representatives represents only one bargaining unit. Since July 2004, the State has negotiated contract changes that result in $47.5 million in General Fund savings in employee compensation from fiscal years 2004–05 through 2005–06. Additionally, the State implemented an Alternate Retirement Program in August 2004 that will result in $85.5 million General Fund savings in fiscal year 2005–06.

ECONOMY AND POPULATION

Introduction

California's economy, the largest among the 50 states and one of the largest in the world, has major components in high technology, trade, entertainment, agriculture, manufacturing, tourism, construction and services. In early 2001, California's economy slipped into a recession, which was concentrated in the State's high-tech sector and, geographically, in the San Francisco Bay Area. The economy has since stabilized with 182,100 jobs gained between July 2003 and December 2004 compared with 341,200 jobs lost between March 2001 and July 2003. See "CURRENT STATE BUDGET AND GOVERNOR'S PROPOSED 2005–06 BUDGET — Economic Assumptions."

Population and Labor Force

The State's July 1, 2003 population of over 35 million represented over 12 percent of the total United States population.

California's population is concentrated in metropolitan areas. As of the April 1, 2000 census, 97 percent resided in the 25 Metropolitan Statistical Areas in the State. As of July 1, 2002, the 5-county Los Angeles area accounted for 49 percent of the State's population, with over 17.0 million residents, and the 10-county San Francisco Bay Area represented 20 percent, with a population of over 7.0 million.

The following table shows California's population data for 1995 through 2004.

TABLE 14
Population 1995-2004[(a)]

Year	California Population	% Increase Over Preceding Year	United States Population	% Increase Over Preceding Year	California as % of United States
1995	31,712,000	0.6%	266,278,393	1.2%	11.9%
1996	31,963,000	0.8	269,394,284	1.2	11.9
1997	32,453,000	1.5	272,646,925	1.2	11.9
1998	32,863,000	1.3	275,854,104	1.2	11.9
1999	33,419,000	1.7	279,040,168	1.2	12.0
2000	34,099,000	2.0	282,192,162	1.1	12.1
2001	34,784,000	2.0	285,102,075	1.0	12.2
2002	35,393,000	1.8	287,941,220	1.0	12.3
2003	35,991,000	1.7	290,788,976	1.0	12.4
2004	36,591,000	1.7	293,655,404	1.0	12.5

(a) Population as of July 1.

Source: U. S. figures from U.S. Department of Commerce, Bureau of the Census; California figures from State of California, Department of Finance.

The following table presents civilian labor force data for the resident population, age 16 and over, for the years 1994 to 2004.

TABLE 15
Labor Force 1994-2004
(Thousands)

Year	Labor Force	Employment	Unemployment Rate (%) California	United States
1994	15,294	13,979	8.6%	6.1%
1995	15,236	14,040	7.8	5.6
1996	15,371	14,261	7.2	5.4
1997	15,786	14,792	6.3	4.9
1998	16,138	15,181	5.9	4.5
1999	16,376	15,522	5.2	4.2
2000	16,892	16,057	4.9	4.0
2001	17,172	16,249	5.4	4.7
2002	17,376	16,215	6.7	5.8
2003	17,460	16,283	6.8	6.0
2004[a]	17,655	16,576	6.1	5.5

(a) Preliminary.

Source: State of California, Employment Development Department.

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Employment, Income, Construction and Export Growth

The following table shows California's non-agricultural employment distribution and growth for 1994 and 2004.

TABLE 16
Payroll Employment By Major Sector
1994 and 2004

	Employment (Thousands)		% Distribution of Employment	
Industry Sector	**1994**	**2004[(a)]**	**1994**	**2004[(a)]**
Trade, Transportation and Utilities	2,351.3	2,746.0	19.3%	18.9%
Government				
Federal Government	324.9	255.2	2.7	1.8
State and Local Government	1,768.3	2,132.9	14.5	14.7
Professional and Business Services	1,586.4	2,169.3	13.0	14.9
Manufacturing				
Nondurable goods	622.8	554.1	5.1	3.8
High Technology	491.6	394.8	4.0	2.7
Other Durable Goods	569.5	580.3	4.7	4.0
Educational and Health Services	1,212.0	1,563.5	10.0	10.8
Leisure and Hospitality	1,143.8	1,414.0	9.4	9.7
Financial Activities	770.3	899.8	6.3	6.2
Construction	475.3	818.7	3.9	5.6
Other Services	420.5	502.5	3.5	3.5
Information	395.8	462.1	3.3	3.2
Natural Resources and Mining	27.1	21.8	0.2	0.2
TOTAL NON-AGRICULTURAL	12,159.5	14,515.1	100%	100%

(a) Preliminary.

Source: State of California, Employment Development Department.

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The following tables show California's total and per capita income patterns for selected years.

TABLE 17
Total Personal Income in California 1994-2003[(a)]

Year	Millions	% Change[(b)]	California % of U.S.
1994[(c)]	$ 730,529	3.2%	12.4%
1995	765,806	4.8	12.4
1996	810,448	5.8	12.3
1997	860,545	6.2	12.4
1998	936,009	8.8	12.5
1999	999,228	6.8	12.7
2000	1,103,842	10.5	13.0
2001	1,134,884	2.8	12.9
2002	1,149,144	1.3	12.9
2003	1,185,302	3.1	12.9

(a) Bureau of Economic Analysis (BEA) estimates as of September 28, 2004.
(b) Change from prior year.
(c) Reflects Northridge earthquake, which caused an estimated $15 billion drop in personal income.

Note: Omits income for government employees overseas.

Source: U.S. Department of Commerce, BEA.

TABLE 18
Per Capita Personal Income 1994-2003[(a)]

Year	California	% Change[(b)]	United States	% Change[(b)]	California % of U.S.
1994[(c)]	$23,203	2.5%	$22,172	3.9%	104.7%
1995	24,161	4.1	23,076	4.1	104.7
1996	25,312	4.8	24,175	4.8	104.7
1997	26,490	4.7	25,334	4.8	104.6
1998	28,374	7.1	26,883	6.1	105.5
1999	29,828	5.1	27,939	3.9	106.8
2000	32,466	8.8	29,847	6.8	108.8
2001	32,864	1.2	30,580	2.5	107.5
2002	32,831	-0.1	30,795	0.7	106.6
2003	33,403	1.7	31,459	2.2	106.2

(a) BEA's estimates as of September 28, 2004.
(b) Change from prior year.
(c) Reflects Northridge earthquake, which caused an estimated $15 billion drop in personal income.

Note: Omits income for government employees overseas.

Source: U.S. Department of Commerce, BEA.

The following tables show California's residential and non-residential construction.

TABLE 19
Residential Construction Authorized by Permits

Year	Units			Valuation[a]
	Total	Single	Multiple	(millions)
1995	85,293	68,689	16,604	$13,879
1996	94,283	74,923	19,360	15,289
1997	111,716	84,780	26,936	18,752
1998	125,707	94,298	31,409	21,976
1999	140,137	101,711	38,426	25,783
2000	148,540	105,595	42,945	28,142
2001	148,757	106,902	41,855	28,804
2002	167,761	123,865	43,896	33,305
2003	195,682	138,762	56,920	38,968
2004[b]	211,731	150,726	61,005	44,560

(a) Valuation includes additions and alterations.

(b) Preliminary.

Source: Construction Industry Research Board

TABLE 20
Nonresidential Construction
(Thousands)

Year	Commercial	Industrial	Other	Additions and Alterations	Total
1995	$2,308,911	$ 732,874	$1,050,693	$4,062,273	$ 8,154,751
1996	2,751,925	1,140,574	1,152,443	4,539,219	9,584,161
1997	4,271,378	1,598,428	1,378,220	5,021,792	12,269,818
1998	5,419,251	2,466,530	1,782,337	5,307,901	14,976,019
1999	5,706,719	2,256,166	2,350,213	6,269,194	16,582,292
2000	6,962,031	2,206,169	2,204,754	7,252,004	18,624,958
2001	6,195,368	1,552,047	2,584,321	6,421,551	16,753,287
2002	5,195,348	1,227,754	2,712,681	5,393,329	14,529,112
2003	4,039,561	1,320,222	2,954,039	5,601,117	13,914,939
2004[a]	5,103,172	1,456,842	3,094,101	6,034,128	15,688,243

(a) Preliminary

Source: Construction Industry Research Board

The following table shows changes in California's exports for the period from 1996 through 2003.

TABLE 21
Exports Through California Ports
(Millions)

Year	Exports[a]	% Change[b]
1996	$124,120.0	6.2%
1997	131,142.7	5.7
1998	116,282.4	-11.3
1999	122,092.8	5.0
2000	148,554.6	21.7
2001	127,255.3	-14.3
2002	111,340.1	-12.5
2003	113,550.7	2.0
2004	123,039.2	8.4

(a) "Free along ship" Value Basis.

(b) Change from prior year.

Source: U.S. Department of Commerce, Bureau of the Census

LITIGATION

The State is a party to numerous legal proceedings. The following are the most significant pending proceedings, as reported by the Office of the Attorney General. See "LITIGATION" in the main body of the Official Statement.

Challenge Seeking Payment to Teacher's Retirement Board

In May 2003, the Legislature enacted legislation (Chapter 6, Statutes of 2003–04, First Extraordinary Session, Senate Bill No. 20, "SBX1 20") that deferred the payment of $500 million to CalSTRS's Supplemental Benefit Maintenance Account ("SBMA"). SBX1 20 also establishes an appropriation of an amount not to exceed $500 million, adjusted by the actual rate of return to funds in the SBMA, in 2006 and every four years thereafter, for the purpose of funding the SBMA. The actual amount of such appropriation, if any, will be determined following a report by the CalSTRS managing board that the funds in the SBMA will be insufficient in any fiscal year before July 1, 2036 to provide certain payments to CalSTRS members, and the certification of the amount of any such appropriation by the State's Director of Finance. On October 14, 2003, the CalSTRS board and certain CalSTRS members filed a complaint, now pending in the Sacramento County Superior Court as *Teacher's Retirement Board, as Manager of the California State Teachers' Retirement System, et al. v. Donna Arduin, Director of California Department of Finance, and Steve Westly, California State Controller* (Case No. 03CS01503). This lawsuit seeks, primarily, a writ of mandate compelling the State Controller to transfer funds from the State's General Fund to the SBMA in an amount equal to the continuing appropriation as it existed prior to the enactment of SBX1 20 ($500 million plus interest). It also seeks injunctive and declaratory relief to the same effect. The State is vigorously defending the action.

Actions Seeking Flood-Related Damages

In January of 1997, California experienced major flooding with preliminary estimates of property damage of approximately $1.6 to $2.0 billion. In *McMahan v. State*, (Sacramento County Superior Court, Case No. 02-AS-06058), a substantial number of plaintiffs have joined suit against the State, local agencies, and private companies and contractors seeking compensation for the damages they suffered as a result of the flooding. These parties have reached a settlement of this matter, which provides for payment of $45 million by the State. It is expected that this agreement will be entered into the record shortly.

Paterno v. State of California (Yuba County Superior Court, Judicial Counsel Coordination Proceeding 2104) is a coordinated action involving 3,000 plaintiffs seeking recovery for damages caused by the Yuba River flood of February 1986. The trial court found liability in inverse condemnation and awarded damages of $500,000 to a sample of plaintiffs. The State's potential liability to the remaining plaintiffs ranges from $800 million to $1.5 billion. In 1992, the State and plaintiffs filed appeals of the decision in the sample plaintiffs' action, and upon remand, plaintiffs' inverse condemnation cause of action was re-tried. The trial court ruled in favor of the State as to all plaintiffs. The appellate court reversed the trial court judgment and remanded the case to the trial court with directions to enter judgment in favor of plaintiffs and ordered the State to pay costs on appeal and costs of suit, including reasonable attorney, appraisal and engineering fees actually incurred. (*Paterno v. State of California* (2003) 113 Cal. App. 4^{th} 998). The Supreme Court denied the State's petition for review, which brought the liability phase of this litigation to a close. The issues of damages, interest, fees, costs and expenses are being litigated in the Yuba County Superior Court.

Tax Refund Cases

Five pending cases challenge the Franchise Tax Board's treatment of receipts from investment of cash in short-term financial instruments, and the resulting impact on the apportionment of corporate income allegedly earned outside of California to the corporation's California tax obligation. In *General Motors Corp. v. Franchise Tax Board*, the California Supreme Court has granted General Motors' petition for review of the appellate court's affirmation of a ruling in favor of the Franchise Tax Board on this issue (*General Motors Corp. v. Franchise Tax Board*, Case No. S127086). *The Limited Stores, Inc. and Affiliates v. Franchise Tax Board* is pending in the Court of Appeal, First Appellate District (Case No. A102915); and *Toys "R" Us, Inc. v. Franchise Tax Board* is pending in the Court of Appeal, Third Appellate District (Case No. C045386). The trial courts in *The Limited Stores* and *Toys "R" Us* ruled in favor of the Franchise Tax Board on this issue. *Montgomery Ward LLC v. Franchise Tax Board* is pending in the San Diego Superior Court (Case No. 802767), and *Colgate-Palmolive v. Franchise Tax Board* is pending in the Sacramento County Superior Court (Case No. 03AS00707); the *Colgate* matter has been stayed, pending the Supreme Court's decision in *General Motors*. On February 25, 2005, the Court of Appeal, First Appellate District issued an unpublished opinion in *Microsoft Corporation v. Franchise Tax Board* (Case No. A105312) in which the court declined to decide this issue, noting that the issue would be resolved by the California Supreme Court in the *General Motors* case. Other taxpayers have raised this same issue in administrative actions. A final decision in favor of any of these plaintiffs could result in tax refunds to similarly situated taxpayers in an amount exceeding $400 million, with a potential future annual revenue loss of $85 million. The State is vigorously litigating this issue.

In *Alan J. Titus and Marjorie Goldman v. County of Marin*, (Court of Appeal, First Appellate District, Division 2, Case No. A104682), the court has issued a decision determining that Marin County had not received property taxes from two taxpayers in excess of the amounts collectable under Article XIII A of the California Constitution (implemented in 1978 by Proposition 13). The plaintiffs' legal claim focused on the constitutionality of the practice of the Marin County assessor's office to increase or "recapture" the assessed values of real properties that temporarily decline and then increase in value.

This decision is not yet final, and it is expected, once it becomes final, the plaintiffs will petition the California Supreme Court for review of this matter. The State is not a party to this pending litigation, but the effects of a final determination by an appellate court that the contested assessment practices are contrary to Proposition 13 could result in an increase in the State general fund component of the financing guarantee to public schools established by Proposition 98 (see "STATE FINANCES — Proposition 98") in an amount in excess of several billion dollars. A similar challenge, addressing whether the County of Orange's assessment practices were contrary to Proposition 13, has been finally decided. In the case of *County of Orange v. Orange County Assessment Appeals Board #3; Bezaire, et al., Real Parties in Interest*, the California Court of Appeal (Fourth Appellate District) issued a unanimous published decision (117 Cal. App. 4th 121) reversing a trial court decision that determined the Orange County assessor's office had received property taxes from two taxpayers in excess of the amounts collectable under Proposition 13.

Environmental Cleanup Matter

In a federal Environmental Protection Agency ("U.S. EPA") administrative abatement action entitled *In the Matter of: Leviathan Mine, Alpine County, California, Regional Water Quality Control Board, Lahontan Region, State of California* (U.S. EPA Region IX CERCLA Docket No. 00-16(a)), the State, as owner of the Leviathan Mine, is a party through the Lahontan Regional Water Quality Control Board ("Board"). Also a party is ARCO, the successor in interest to the mining company that caused certain pollution of the mine site. The Leviathan Mine site is listed on the U.S. EPA "Superfund" List, and both remediation costs and costs for Natural Resource Damages may be imposed on the State. The alleged bases for the State's liability are the State's ownership of the mine site and the terms of a 1983 settlement agreement with ARCO. The Board has undertaken certain remedial action at the mine site, but the U.S. EPA's decision on the interim and final remedies are pending. ARCO has filed several state law claims against the State with the California Victim Compensation and Government Claims Board (an administrative agency with which certain claims must be filed as a prerequisite to litigation seeking damages against the State which was formerly named the Board of Control, the "Government Claims Board"). Litigation on these claims has been tolled by agreement among the parties until October 1, 2006. It is possible these matters could result in a potential loss to the State in excess of $400 million.

Energy-Related Matters

In *People v. ACN Energy, Inc., et al.* (Sacramento County Superior Court, Case No. 01AS05497), the court is considering whether and to what extent compensation is due to market participants which have claimed compensation as a result of the Governor's issuance of executive orders, under the California Emergency Service Act, "commandeering" power purchase arrangements held by Pacific Gas & Electric Company ("PG&E") and Southern California Edison ("SCE"), referred to as "block forward contracts." In this action the State seeks a declaration that the State is not liable for damages as a result of these orders, nor for compensation for inverse condemnation, and that any damages suffered by any of the defendants is offset by payments made by the Department of Water Resources for electricity received under the "commandeered" "block forward contracts." Complaints and cross-complaints for inverse condemnation, recovery under the Emergency Services Act and other causes of action brought by PG&E, Reliant Energy Services, Dynegy Power Marketing, Williams Energy Services, Sempra Energy Trading, the California Power Exchange, Mirant Americas Energy, Duke Energy Trading and Marketing, and numerous other market participants have been joined with the declaratory relief action in Judicial Council Coordination Proceeding No. 4203, in Sacramento County Superior Court. In an administrative proceeding action before the Government Claims Board (which was dismissed on procedural grounds), the California Power Exchange stated claims for "commandeering" the "block forward contracts" in the amount of approximately $1 billion.

Escheated Property Claims

In three pending cases, plaintiffs claim that the State Controller has a constitutional and statutory duty to give notice prior to the time the Controller sells property that has escheated to the State (in these cases, shares of stock): *Lusby-Taylor v. Westly* (U.S. Court of Appeals, Ninth Circuit, Case No. 02-16511); *Orfield v. Westly* (Los Angeles County Superior Court, Case No. BC288429); and *Suever v. Westly* (U.S. Court of Appeals, Ninth Circuit, Case No. 04-15555). The plaintiffs also claim that the Controller failed to comply with statutory notice requirements when it first received property that had escheated to the State. The plaintiffs seek damages, which certain plaintiffs have articulated as being in the amount of the difference between the amount they were paid for the stock upon its sale, and either the current value of the stock or the highest market value of the stock between the date the Controller sold the stock and the present. The State is vigorously defending all of these actions. *Orfield* is being litigated in the trial court. The State prevailed at the trial court in *Suever*, which is now pending appeal. The State also prevailed at the trial court in *Lusby-Taylor*, where the court ruled that it lacked jurisdiction under the Eleventh Amendment. However, the Court of Appeal has recently reversed that ruling, which returns the case to the trial court for a ruling on the merits. The State intends to petition for a rehearing of the *Lusby-Taylor* decision. If one or more of these cases is certified as a class action and the class ultimately prevails on the damages claim, damages for the class could be in excess of $500 million. All of these cases are styled as class actions, though no class has yet been certified in any of the cases. The State has ultimately prevailed in two cases in which plaintiffs also claimed that the Controller's unclaimed property notice practices were unconstitutional and failed to meet statutory requirements: *Fong v. Westly* (2004) 117 Cal. App. 4th 841 and *Harris v. Westly* (2004) 116 Cal. App. 4th 214.

In three pending cases, plaintiffs claim that the State Controller has an obligation to pay interest on private property that has escheated to the State, and that failure to do so constitutes an unconstitutional taking of private property: *Morris v. Westly* (Los Angeles County Superior Court, Case No. BC310200); *Trust Realty Partners v. Westly* (Sacramento County Superior Court, Case No. 04AS02522); and *Browne v. Westly* (Sacramento County Superior Court, Case No. 04AS02570). The *Browne* and *Trust Realty* lawsuits focus on the State's elimination of interest payments on unclaimed property claims (Code of Civil Procedure Section 1540, subdivision (c), as amended effective August 11, 2003, "CCP 1540"), and the *Morris* lawsuit challenges both the elimination of interest and whether the State's custodial use of escheated funds entitles the claimant to constructive interest. The *Morris* case seeks a class action determination, and identifies a purported class that could be interpreted to include all persons or entities whose property has been taken into custody by the State. On behalf of the articulated class, the plaintiff in *Morris* seeks a declaration that failure to pay interest is an unconstitutional taking and, among other things, an injunction restraining the State Controller from pursuing the practices complained of in the complaint. The *Browne* and *Trust Realty Partners* cases are not styled as class actions suits, but in addition to seeking general and special damages in a sum according to proof at trial, each case seeks a common fund recovery and an injunction restraining the Controller from engaging in the acts alleged in their respective complaints. If the *Morris* case ultimately prevails as a class action, or the injunctions prayed for in either of the *Browne* or *Trust Realty Partners* cases are issued and upheld, in any case to require the State Controller to pay interest on escheated property as the plaintiffs allege is required by law, costs to the State could be in excess of $500 million.

Action Seeking Damages for Alleged Violations of Privacy Rights

In *Gail Marie Harrington-Wisely, et al. v. State of California, et al.* (Los Angeles County Superior Court, Case No. BC 227373), a proposed class action, plaintiffs seek damages for alleged violations of prison visitors' rights resulting from the Department of Corrections' use of a body imaging machine to search visitors entering state prisons for contraband. This matter has been certified as a class action for the purpose of determining liability. The court has deferred its ruling on certifying a class for the purpose of determining damages. If this action is certified as a class action for purposes of damages, and a court were to award damages pursuant to the California Civil Code for every use of the body imaging machine, damages could be as high as $3 billion. Trial is currently scheduled to begin in September 2005.

Action Seeking A Cost of Living Adjustment for CalWORKs Recipients

The case of *Juana Raquel Guillen, et al. v. Schwarzenegger, et al.* is currently pending before the Court of Appeal (First Appellate District, Division 3; Case No. A106873). The trial court decision on appeal in this case determined that Governor Schwarzenegger's executive order in November 2003, which reduced the Vehicle License Fee charged to vehicle owners and increased the corresponding Vehicle License Fee offset to local governments (See "STATE FINANCES — Local Governments — Vehicle License Fee"), acted as an "increase in tax relief", which, by statute, triggers an upward cost of living adjustment for recipients of CalWORKs program benefits. The petitioners seek a cost of living adjustment, beginning with fiscal year 2003–04. The estimated cost of the State of a final, unappealable determination consistent with the determination of the trial court, is now estimated to be approximately $250 million.

Actions Seeking Program Modifications

In the following cases, plaintiffs seek court orders or judgments that would require the State to modify existing programs and, except as specified, do not seek monetary damages. Nevertheless, a judgment against the State in any one of these cases could require changes in the challenged program that could result in increased programmatic costs to the State in a future fiscal year in excess of $250 million. Alternatively, in some circumstances, it may be possible that a judgment against the State could be addressed by legislative changes to the program that would cost less.

In *Natural Resources Defense Council, et al. v. California Department of Transportation, et al.* (U.S. District Court, Central District, Case No. 93-6073-ER-(JRX)), plaintiffs obtained an injunction requiring the Department of Transportation (the "Department") to comply with National Pollution Discharge Elimination System ("NPDES") requirements under the federal Clean Water Act ("Act") in connection with storm water discharges from State highways and construction sites in an area that includes most of Los Angeles and Ventura Counties. There is an established dispute resolution procedure intended to resolve disputes without a return to federal court. Subsequent modifications of the injunction have provided for, among other things, studies of pilot projects to address control of the sources of storm water pollution and the performance of studies of pilot projects to retrofit highways with storm water pollution control facilities. There has been no agreement regarding what measures arising out of the pilot projects and studies will be implemented. Plaintiffs' position is that the Department should be required to retrofit its facilities to treat storm water, regardless of whether any construction is otherwise planned in any given area. For planning purposes, the Department is including an additional 3 percent in the cost of future statewide construction and maintenance projects to pay for compliance measures. This 3 percent increase amounts to $500 million through fiscal year 2006–07. While the impact of a judgment of the scope sought by plaintiffs is difficult to determine, it is possible that a judgment that would require the State to retrofit all its highway facilities throughout the State could cost billions of dollars.

The matter of *Conlan v. Bonta* is now pending before the Court of Appeal (First Appellate District, Case No. A106278). This appeal follows a prior appellate court decision determining that the State's Medi-Cal program violates federal law because the program fails to promptly reimburse medical payments made by patients within the 90-day window prior to submitting an application for Medi-Cal benefits. The State's Medi-Cal program relies on Medi-Cal providers to reimburse beneficiaries for out-of-pocket expenses paid during this retroactive "reimbursement window" period. On remand following this appellate decision, the trial court ordered the Department of Health Services to develop a compliance plan to implement the appellate decision. The trial court rejected the proposed plan, and ordered the Department of Health Services to take certain steps to provide for additional reimbursement to Medi-Cal recipients. The pending action is the Department of Health Services' appeal of that decision. At issue in the action are certain administrative procedures ordered by the trial court. While the impact of the cost of complying with the trial court's plan for reimbursement is unknown, certain estimates of the costs of the administrative due process procedures required by the court, when combined with the cost of reimbursements that the Department of Health Services now believes may not be eligible for federal off-set, may be in excess of $250 million.

The following cases seek reforms to State programs for the treatment of institutionalized disabled persons. Some rough estimates suggest the financial impact of a judgment against the State defendants in any of these cases could be as high as $1 billion per year in programmatic costs going forward. The State is vigorously defending these actions.

In *Stephen Sanchez, et al. v. Grantland Johnson, et al.* (U.S. Court of Appeals, Ninth Circuit, Case No 04-15228), the plaintiffs have appealed a decision by the U.S. District Court dismissing plaintiffs' class action seeking declaratory and injunctive relief. The plaintiffs sought relief, alleging, in part, that provider rates for community-based services for developmentally disabled individuals are discriminatory under the ADA, and violate the Social Security Act, Civil Rights Act and the Rehabilitation Act, because they result in unnecessary institutionalization of developmentally disabled persons.

In *Capitol People First v. Department of Developmental Services* (Alameda County Superior Court, Case No. 2002-038715) a consortium of state and national law firms and public-interest groups brought suit against the Departments of Finance, California Department of Developmental Services and California Department of Health Services, alleging violations of the Lanterman Act, the ADA, and section 504 of the Rehabilitation Act by defendants needlessly isolate thousands of people with developmental disabilities in large facilities. The case seeks sweeping reforms, including requiring the State to offer a full range of community-based services.

Local Government Mandate Claims and Actions

In a test claim filed by the County of San Bernardino, now pending before the Commission on State Mandates (the "Commission") (Medically Indigent Adults, 01-TC-26 County of San Bernardino, Claimant, Statutes 1982, Chapters 328 and 1594), the Commission is being asked to determine the costs incurred by the county to provide state-mandated care of medically indigent adults ("MIAs"). The amount demanded in the claim for un-reimbursed costs for fiscal year 2000-2001 is just over $9.2 million. The County of San Bernardino's test claim poses a potential for a negative impact on the General Fund in the amount of the un-reimbursed costs for all similarly situated county claimants for a period of years, as determined by the Commission. Certain estimates of the annual cost of the services rendered by all counties to MIAs exceed $4 billion. How much of that will be determined to be "un-reimbursed" to the counties by the State is unknown. In recent years, the counties have received approximately $1 billion annually in vehicle license fee revenue and $410 million annually in sales tax revenue to fund various public health programs, which include the programs that provide services to MIAs. The State law that authorized the transfer of the vehicle license fee portion of this revenue to the counties and the authority to transfer the revenue to the counties were automatically repealed as a result of a provision of State law, which was triggered as a result of a final appellate court decision (*County of San Diego v. Commission on State Mandates, et al.* Fourth Appellate District, Case No. D039471; petition for review denied by the California Supreme Court) that awarded the County of San Diego un-reimbursed costs for medical services rendered to MIAs. Various regulatory and statutory steps have been and are being taken to address this reduction in revenues. See "STATE FINANCES — Local Governments — Vehicle License Fee."

Two lawsuits are pending that challenge the State's practice in recent years of deferring payments to local governments for certain state-mandated services and programs by making a budgetary appropriation of $1,000 for each program, to be divided among all 58 counties, violates the State Constitution. These lawsuits were consolidated in San Diego County Superior Court (*County of San Diego v. State of California, et al.* (Case No. GIC 825109) and *County of Orange v. State of California, et al.* (Case No. GIC 827845)). These plaintiff counties are seeking full payment for the un-reimbursed costs of implementing a variety of programs over the last few years. The County of San Diego has alleged un-reimbursed costs in excess of $40 million through fiscal year 2003–04 for a variety of programs. The County of Orange has alleged in excess of $116 million for un-reimbursed state-mandated costs. The court has granted a motion, in part, declaring that the State's practice violates the Constitution, and has further ruled that Senate Constitutional Amendment No. 4, approved by the voters as Proposition 1A at the November 2004 election (See "STATE FINANCES — Local Governments"), did not change this result. The amount of the un-reimbursed mandates remains undetermined. The effects of a final determination by an appellate court that the contested appropriation practices are unconstitutional or that the State is required to appropriate an amount equal to the amount of the mandated costs, if applied to each of California's 58 counties, could result in costs in excess of $1.5 billion for existing un-reimbursed mandates.

Action for Damages for Alleged Destruction at Indian Burial Sites

On January 16, 2004, *John Tommy Rosas v. United States of America, et al.* was filed in the U.S. District Court, Central District (Case No. CV04-312 WMB (SSx)). Plaintiff, in his individual capacity and as the alleged vice-chairman of the Tribal Counsel, Gabrielino/Tongva Indians of California, alleges violation of various federal statutes by a variety of federal agencies, corporations, individuals and four State entities (the California Coastal Commission, the Regional Water Quality Control Board, the State Historic Preservation Officer and the California Native American Heritage Commission). Plaintiff alleges that in allowing the development of certain property, defendants violated federal laws protecting sacred Indian burial sites. Plaintiff seeks damages in the amount of $525 million. Plaintiff has not properly served the California state agency defendants. In February 2004, the corporate defendants filed a motion to dismiss. Plaintiff has not responded to this motion, and it remains pending before the court.

Actions Seeking to Enjoin Implementation of Certain Tribal Gaming Compacts

In June 2004, the State entered into amendments to tribal gaming compacts between the State and five Indian Tribes (the "Amended Compacts"). Those Amended Compacts are being challenged in two pending cases, as described below. A decision in either of these cases that is unfavorable to the State could eliminate $300 million in additional revenues anticipated to result from the Amended Compacts, and could delay or impair the State's ability to sell a portion of the revenue stream anticipated to be generated by these Amended Compacts. The State anticipates using the proceeds of that sale to repay existing internal borrowings of transportation funds. See "CURRENT STATE BUDGET AND GOVERNOR'S PROPOSED 2005–06 BUDGET — 2004 Budget Act." The failure to repay these existing transportation loans could, in turn, result in a reduction of anticipated internal borrowable resources in an amount of approximately $500 million.

In *Rincon Band of Luiseno Mission Indians of the Rincon Reservation v. Schwarzenegger, et al.* (U.S. District Court, Case No. 04 CV 1151 W (WMc)) the plaintiff (the "Rincon Band"), a federally recognized Indian Tribe, alleges, in primary part, that a compact entered into between the Rincon Band and the State in 1999, is part of a statewide regulatory framework that limits gaming devices and licenses on non–Indian lands for the stated goal of promoting tribal economic development. The plaintiff further alleges that the Amended Compacts would materially alter these protections, and as such, would constitute an unconstitutional impairment of the Rincon Band's 1999 compact. The complaint filed by the Rincon Band seeks, among other things, an injunction against the implementation of the Amended Compacts. The District Court denied plaintiff's motion for injunctive relief, and dismissed the complaint on a procedural basis. The matter is currently on appeal in the U.S. Court of Appeal, Ninth Circuit (Case No. 04-56396). The appeal was stayed pending the District Court's ruling on a motion for reconsideration of a portion of the District Court's order, brought by the plaintiff. The District Court granted that request in part, but dismissed two of plaintiffs' claims affecting the Amended Compacts. The State is considering its options as a result of this recent decision.

Craig, et al. v. Schwarzenegger, et al. (Alameda County Superior Court, Case No. RG04175471) is an action brought by the owners of various racetracks and an individual plaintiff and petitioner, challenging the Legislature's recent ratification of the tribal compact amendments described above, which was done through urgency legislation (Statutes 2004, Chapter 91; "Chapter 91"). Plaintiffs and petitioners allege that Chapter 91 violates a provision of the California Constitution, which bars the grant of vested rights or franchises in an urgency measure, and allege a variety of special privileges and vested rights and interests purportedly created by Chapter 91. As amended, the plaintiffs' and petitioners' complaint also alleges that Chapter 91 violates recently enacted provisions of the California Constitution which prohibit certain borrowings to fund a year–end state budget deficit ("Proposition 58"); and constitutes an unconstitutional attempt to contract away the State's police power. Plaintiffs and petitioners seek an injunction restraining the implementation of Chapter 91; a decision prohibiting the implementation of Chapter 91; and a declaration that Chapter 91 is unconstitutional. The owner of a card room, and an individual, are seeking to intervene in this case.

Matter Seeking Validation of Pension Obligation Bonds

The Legislature enacted the California Pension Restructuring Bond Act of 2004 (Government Code sections 16940 et seq.), which authorized the Pension Obligation Bond Committee (the "Committee") to issue bonds to fund all or a portion of the State's pension obligation in any two fiscal years. Pursuant to that authorization, the Committee authorized the issuance of bonds in an amount not to exceed \$960 million to pay a portion of the State's pension obligation for fiscal year 2004–05. The Committee also resolved to seek court validation of the bonds and the indenture pertaining to the bonds pursuant to a validation process established by Code of Civil Procedure sections 860 et seq. On October 22, 2004, the Committee filed *Pension Obligation Bond Committee v. All Persons Interested in the Matter of the Validity of the State of California's Pension Obligation, etc.* (Sacramento County Superior Court, Case No. 04AS043032994). An answer was filed by a public interest group, and the matter will proceed to trial. The State will not be able to issue pension obligation bonds until this matter is finally resolved.

STATE DEBT TABLES

The tables which follow provide information on outstanding State debt, authorized but unissued general obligation bonds and commercial paper notes, debt service requirements for State general obligation and lease-purchase bonds, and authorized and outstanding State revenue bonds. For purposes of these tables, "General Fund bonds," also known as "non-self liquidating bonds," are general obligation bonds expected to be paid from the General Fund without reimbursement from any other fund. Although the principal of general obligation commercial paper notes in the "non-self liquidating" category is legally payable from the General Fund, the State expects that principal of such commercial paper notes will be paid only from the issuance of new commercial paper notes or the issuance of long-term general obligation bonds to retire the commercial paper notes. Interest on "non-self liquidating" general obligation commercial paper notes is payable from the General Fund.

"Enterprise Fund bonds," also known as "self liquidating bonds," are general obligation bonds for which program revenues are expected to be sufficient to reimburse in full the General Fund for debt service payments, but any failure to make such a reimbursement does not affect the obligation of the State to pay principal and interest on the bonds from the General Fund.

"Special Revenue Fund bonds" also known as "economic recovery bonds," are "self liquidating" general obligation bonds which are primarily secured by a pledge of a one-quarter cent statewide sales and use tax deposited in the Fiscal Recovery Fund. Debt service payments are made directly from the Fiscal Recovery Fund and not the General Fund. The Special Revenue Fund bonds are also general obligations of the State to which the full faith and credit of the State are pledged to the punctual payment of the principal of and interest thereon.

As of April 15, 2005 the State had $140,780,000 of outstanding commercial paper notes.

The following tables do not reflect the $763,500,000 of State general obligation refunding bonds, which are expected to be delivered on April 20, 2005.

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OUTSTANDING STATE DEBT
FISCAL YEARS 1999-00 THROUGH 2003-04
(Dollars in Thousands Except for Per Capita Information)

	1999-00	2000-01	2001-02	2002-03	2003-04
Outstanding Debt (a)					
General Obligation Bonds					
General Fund (Non-Self Liquidating)	$ 17,869,616	$ 20,472,893	$ 22,115,362	$ 26,758,626	$ 33,028,807
Enterprise Fund (Self Liquidating)	3,474,900	3,396,215	3,211,310	2,801,775	2,210,800
Special Revenue Fund (Self-Liquidating)	0	0	0	0	10,896,080
Total	$ 21,344,516	$ 23,869,108	$ 25,326,672	$ 29,560,401	$ 46,135,687
Lease-Purchase Debt	6,627,944	6,413,260	6,341,935	6,704,599	7,288,147
Total Outstanding General Obligation Bonds and Lease-Purchase Debt	$ 27,972,460	$ 30,282,368	$ 31,668,607	$ 36,265,000	$ 53,423,834
Bond Sales During Fiscal Year					
Non-Self Liquidating General Obligation Bonds	$ 2,750,000	$ 4,419,665	$ 3,905,025	$ 5,150,000	$ 7,816,275
Self Liquidating General Obligation Bonds	$ 126,500	$ 358,625	$ 111,325	$ 0	$ 0
Self Liquidating Special Fund Revenue Bonds	$ 0	$ 0	$ 0	$ 0	$ 10,896,080
Lease-Purchase Debt	$ 293,235	$ 214,585	$ 229,105	$ 673,975	$ 1,235,660
Debt Service (b)					
Non-Self Liquidating General Obligation Bonds	$ 2,045,566	$ 2,279,636	$ 2,367,570	$ 1,738,740	$ 1,861,739
Lease-Purchase Debt	$ 654,485	$ 670,228	$ 647,568	$ 664,846	$ 689,851
General Fund Receipts (c)	$ 72,226,473	$ 78,330,406	$ 66,604,508	$ 78,587,019	$ 90,639,818
Non-Self Liquidating General Obligation Bonds Debt Service as a Percentage of General Fund Receipts	2.83%	2.91%	3.55%	2.21%	2.05%
Lease-Purchase Debt Service as a Percentage of General Fund Receipts	0.91%	0.86%	0.97%	0.85%	0.76%
Population (d)	33,419,000	34,099,000	34,784,000	35,393,000	35,991,000
Non-Self Liquidating General Obligation Bonds Outstanding Per Capita	$ 534.71	$ 600.40	$ 635.79	$ 756.04	$ 917.70
Lease-Purchase Debt Outstanding Per Capita	$ 198.33	$ 188.08	$ 182.32	$ 189.43	$ 202.50
Personal Income (e)	$ 999,228,000	$1,103,842,000	$1,134,884,000	$1,149,144,000	$ 1,185,302,000
Non-Self Liquidating General Obligation Bonds Outstanding as Percentage of Personal Income	1.79%	1.85%	1.95%	2.33%	2.79%
Lease-Purchase Debt Outstanding as Percentage of Personal Income	0.66%	0.58%	0.56%	0.58%	0.61%

(a) As of last day of fiscal year. Includes the initial value of capital appreciation bonds rather than the accreted value.
(b) Calculated on a cash basis. Debt service costs of bonds issued in any fiscal year largely appear in the subsequent fiscal year. For FY 2002-03 and FY 2003-04, General Obligation Bond Debt Service was reduced through a debt restructuring program which included the use of proceeds from current refunding bonds to pay certain bonds maturing in those years.
(c) Calculated on a cash basis. General Fund Receipts includes both revenues and nonrevenues, such as borrowings the proceeds of which are deposited in the General Fund (e.g. economic recovery bonds and tobacco securitization bonds).
(d) As of July 1, the beginning of the fiscal year.
(e) Source: U.S. Department of Commerce, Bureau of Economic Analysis, http://www.bea.doc.gov/
Annual Totals: "Pre-benchmark" Revisions: Released April 2004. California Department of Finance.

SOURCES: Population: State of California, Department of Finance
Personal Income: State of California, Department of Finance; United States, Department of Commerce, Bureau of Economic Analysis (BEA)
Outstanding Debt, Bonds Sales During Fiscal Year and Debt Service: State of California, Office of the Treasurer.
General Fund Receipts: State of California, Office of the State Controller.

AUTHORIZED AND OUTSTANDING GENERAL OBLIGATION BONDS

As of April 1, 2005

(Thousands)

	Voter Authorization Date	Voter Authorization Amount	Bonds Outstanding (a)	CP Program Authorized (b)	Unissued (c)
GENERAL FUND BONDS (Non-Self Liquidating)					
1988 School Facilities Bond Act	11/08/88	800,000	379,635	2,255	0
1990 School Facilities Bond Act	06/05/90	800,000	406,560	2,125	0
1992 School Facilities Bond Act	11/03/92	900,000	529,877	4,789	0
California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Act of 2002	03/05/02	2,600,000	341,970	1,226,640	1,030,130
California Library Construction and Renovation Bond Act of 1988	11/08/88	75,000	42,785	0	2,595
California Park and Recreational Facilities Act of 1984	06/05/84	370,000	99,090	N/A	1,100
California Parklands Act of 1980	11/04/80	285,000	20,115	N/A	0
California Reading and Literacy Improvement and Public Library Construction and Renovation Bond Act of 2000	03/07/00	350,000	28,585	85,425	235,950
California Safe Drinking Water Bond Law of 1976	06/08/76	175,000	29,705	N/A	2,500
California Safe Drinking Water Bond Law of 1984	11/06/84	75,000	18,540	N/A	0
California Safe Drinking Water Bond Law of 1986	11/04/86	100,000	53,640	N/A	0
California Safe Drinking Water Bond Law of 1988	11/08/88	75,000	46,910	6,975	0
California Wildlife, Coastal, and Park Land Conservation Act	06/07/88	776,000	357,815	N/A	7,330
Children's Hospital Bond Act of 2004	11/02/04	750,000	0	0	750,000
Class Size Reduction Kindergarten-University Public Education Facilities Bond Act of 1998 (Higher Education)	11/03/98	2,500,000	2,247,695	185,875	0
Class Size Reduction Kindergarten-University Public Education Facilities Bond Act of 1998 (K-12)	11/03/98	6,700,000	6,253,265	11,860	0
Clean Air and Transportation Improvement Bond Act of 1990	06/05/90	1,990,000	1,310,770	198,875	15,630
Clean Water Bond Law of 1970	11/03/70	250,000	3,000	N/A	0
Clean Water Bond Law of 1974	06/04/74	250,000	6,635	N/A	0
Clean Water Bond Law of 1984	11/06/84	325,000	62,800	N/A	0
Clean Water and Water Conservation Bond Law of 1978	06/06/78	375,000	22,680	N/A	0
Clean Water and Water Reclamation Bond Law of 1988	11/08/88	65,000	43,960	0	0
Community Parklands Act of 1986	06/03/86	100,000	32,710	N/A	0
County Correctional Facility Capital Expenditure Bond Act of 1986	06/03/86	495,000	171,205	N/A	0
County Correctional Facility Capital Expenditure and Youth Facility Bond Act of 1988	11/08/88	500,000	273,800	0	0
County Jail Capital Expenditure Bond Act of 1981	11/02/82	280,000	35,800	N/A	0
County Jail Capital Expenditure Bond Act of 1984	06/05/84	250,000	33,900	N/A	0
Earthquake Safety and Public Buildings Rehabilitation Bond Act of 1990	06/05/90	300,000	217,125	39,960	0

AUTHORIZED AND OUTSTANDING GENERAL OBLIGATION BONDS

As of April 1, 2005

(Thousands)

	Voter Authorization Date	Voter Authorization Amount	Bonds Outstanding (a)	CP Program Authorized (b)	Unissued (c)
GENERAL FUND BONDS (Non-Self Liquidating)					
Fish and Wildlife Habitat Enhancement Act of 1984	06/05/84	85,000	21,125	N/A	0
Hazardous Substance Cleanup Bond Act of 1984	11/06/84	100,000	2,500	N/A	0
Higher Education Facilities Bond Act of 1986	11/04/86	400,000	93,150	N/A	0
Higher Education Facilities Bond Act of 1988	11/08/88	600,000	265,025	0	10,440
Higher Education Facilities Bond Act of June 1990	06/05/90	450,000	229,370	980	1,130
Higher Education Facilities Bond Act of June 1992	06/02/92	900,000	607,135	0	7,235
Housing and Emergency Shelter Trust Fund Act of 2002	11/05/02	2,100,000	14,875	965,125	1,120,000
Housing and Homeless Bond Act of 1990	06/05/90	150,000	5,965	N/A	0
Kindergarten-University Public Education Facilities Bond Act of 2002 (Higher Education)	11/05/02	1,650,000	325,565	907,085	416,000
Kindergarten-University Public Education Facilities Bond Act of 2002 (K-12)	11/05/02	11,400,000	8,652,790	2,701,365	0
Kindergarten-University Public Education Facilities Bond Act of 2004 (Hi-Ed)	03/02/04	2,300,000	0	726,476	1,573,524
Kindergarten-University Public Education Facilities Bond Act of 2004 (K-12)	03/02/04	10,000,000	413,625	9,586,375	0
Lake Tahoe Acquisitions Bond Act	08/02/82	85,000	20,185	N/A	0
New Prison Construction Bond Act of 1981	06/08/82	495,000	19,500	N/A	0
New Prison Construction Bond Act of 1984	06/05/84	300,000	17,500	N/A	0
New Prison Construction Bond Act of 1986	11/04/86	500,000	132,380	N/A	0
New Prison Construction Bond Act of 1988	11/08/88	817,000	364,340	8,570	0
New Prison Construction Bond Act of 1990	06/05/90	450,000	211,350	2,307	298
Passenger Rail and Clean Air Bond Act of 1990	06/05/90	1,000,000	536,365	0	0
Public Education Facilities Bond Act of 1996 (Higher Education)	03/26/96	975,000	840,655	28,765	8,700
Public Education Facilities Bond Act of 1996 (K-12)	03/26/96	2,025,000	1,659,790	23,465	0
Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Act	03/07/00	1,970,000	605,010	477,317	873,800
Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection Bond Act of 2000	03/07/00	2,100,000	1,041,155	499,710	528,805
Safe, Clean, Reliable Water Supply Act	11/05/96	995,000	606,810	346,730	0
School Building and Earthquake Bond Act of 1974	11/05/74	40,000	29,320	N/A	0
School Facilities Bond Act of 1988	06/07/88	800,000	331,035	N/A	0
School Facilities Bond Act of 1990	11/06/90	800,000	447,370	0	0
School Facilities Bond Act of 1992	06/02/92	1,900,000	1,101,825	15,055	0
Seismic Retrofit Bond Act of 1996	03/26/96	2,000,000	1,641,890	185,530	0

AUTHORIZED AND OUTSTANDING GENERAL OBLIGATION BONDS

As of April 1, 2005

(Thousands)

	Voter Authorization Date	Voter Authorization Amount	Bonds Outstanding (a)	CP Program Authorized (b)	Unissued (c)
GENERAL FUND BONDS (Non-Self Liquidating)					
Senior Center Bond Act of 1984	11/06/84	50,000	4,750	N/A	0
State Beach, Park, Recreational and Historical Facilities Bond Act of 1974	06/04/74	250,000	0	N/A	0
State School Building Lease-Purchase Bond Law of 1982	11/02/82	500,000	5,250	N/A	0
State School Building Lease-Purchase Bond Law of 1984	11/06/84	450,000	75,250	N/A	0
State School Building Lease-Purchase Bond Law of 1986	11/04/86	800,000	210,900	N/A	0
State, Urban, and Coastal Park Bond Act of 1976	11/02/76	280,000	11,490	N/A	0
Stem Cell Research and Cures Act of 2004	11/02/04	3,000,000	0	0	3,000,000
Veterans Homes Bond Act of 2000	03/07/00	50,000	3,080	41,920	5,000
Voting Modernization Bond Act of 2002	03/05/02	200,000	42,380	93,870	45,000
Water Conservation Bond Law of 1988	11/08/88	60,000	37,715	9,525	0
Water Conservation and Water Quality Bond Law of 1986	06/03/86	150,000	61,330	N/A	27,600
Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002	11/05/02	3,440,000	499,590	827,800	2,107,900
Total General Fund Bonds		79,128,000	34,259,912	19,212,749	11,770,667
ENTERPRISE FUND BONDS (Self Liquidating)					
California Water Resources Development Bond Act	11/08/60	1,750,000	738,440	N/A	167,600
Veterans Bond Act of 1980	06/03/80	750,000	60,150	0	0
Veterans Bond Act of 1982	11/02/82	450,000	107,000	0	0
Veterans Bond Act of 1984	11/06/84	650,000	223,900	0	0
Veterans Bond Act of 1986	06/03/86	850,000	266,135	0	0
Veterans Bond Act of 1988	06/07/88	510,000	234,155	0	0
Veterans Bond Act of 1990	11/06/90	400,000	181,385	0	0
Veterans Bond Act of 1996	11/05/96	400,000	163,590	105,585	0
Veterans Bond Act of 2000	11/07/00	500,000	0	129,985	370,015
Total Enterprise Fund Bonds		6,260,000	1,974,755	235,570	537,615

AUTHORIZED AND OUTSTANDING GENERAL OBLIGATION BONDS

As of April 1, 2005

(Thousands)

	Voter Authorization Date	Voter Authorization Amount	Bonds Outstanding (a)	CP Program Authorized (b)	Unissued (c)
SPECIAL REVENUE FUND BONDS (Self Liquidating)					
Economic Recovery Bond Act	04/10/04	15,000,000	10,896,080	N/A	4,103,920
Total Special Revenue Fund Bonds		15,000,000	10,896,080	0	4,103,920
TOTAL GENERAL OBLIGATION BONDS		100,388,000	47,130,747	19,448,319	16,412,202

(a) Includes the initial value of capital appreciation bonds rather than the accreted value.
(b) Represents the total amount of commercial paper authorized by Finance Committees that could be issued for new money projects. Of this amount, no more than $1.5 billion of commercial paper principal and interest can be owing at any time. Currently, there is $70,780,000.00 of commercial paper issued and outstanding. The bond acts marked as "n.a." are not legally permitted to utilize commercial paper, or all bonds were issued before the commercial paper program began.
(c) Treats full commercial paper authorization as issued; see footnote(b).

SOURCE: State of California, Office of the Treasurer.

GENERAL OBLIGATION AND LEASE REVENUE BONDS
SUMMARY OF DEBT SERVICE REQUIREMENTS
As of April 1, 2005

	Total Debt		
	Interest	**Principal (a)**	**Total**
GENERAL OBLIGATION BONDS			
GENERAL FUND NON-SELF LIQUIDATING			
Fixed Rate	$ 22,401,032,386.34	$ 31,859,912,123.47	$ 54,260,944,509.81
Variable Rate (b)	667,757,621.27	2,400,000,000.00	3,067,757,621.27
ENTERPRISE FUND SELF LIQUIDATING			
Fixed Rate	1,038,762,712.10	1,974,755,000.00	3,013,517,712.10
SPECIAL REVENUE FUND SELF LIQUIDATING (c)			
Fixed Rate	2,566,423,375.52	6,921,515,000.00	9,487,938,375.52
Variable Rate (d)	865,362,744.36	3,974,565,000.00	4,839,927,744.36
REVENUE BONDS			
GENERAL FUND LEASE REVENUE			
Lease Purchase	3,827,161,165.21	7,158,477,629.22	10,985,638,794.43
General Fund and Lease Revenue Total (e)	**$ 31,366,500,004.80**	**$ 54,289,224,752.69**	**$ 85,655,724,757.49**

(a) Includes scheduled mandatory sinking fund payments.
(b) The estimate of future interest payments is based on rates in effect as of November 1, 2004.
(c) Economic Recovery Bonds.
(d) The estimate of future interest payments is based on rates in effect as of June 30, 2004. $1,000,000,000 of Series 2004B bonds bear interest at fixed rates ranging from 3.00-5.00% until reset dates on July 1, 2007 and July 1, 2008, and are assumed to bear interest at the rate of 3.33% from each reset date to maturity.
(e) Estimated interest included.

SOURCE: State of California, Office of the Treasurer.

SCHEDULE OF DEBT SERVICE REQUIREMENTS FOR GENERAL FUND NON-SELF LIQUIDATING BONDS
Fixed Rate
As of April 1, 2005

Fiscal Year Ending June 30	Current Debt			
	Interest	Principal (a)	Total	
2005	194,749,188.90	173,160,000.00	367,909,188.90	(b)
2006	1,631,839,802.50	1,321,265,000.00	2,953,104,802.50	
2007	1,557,918,568.43	1,353,715,000.00	2,911,633,568.43	
2008	1,486,932,745.43	1,509,748,078.31	2,996,680,823.74	
2009	1,405,301,881.25	1,582,295,000.00	2,987,596,881.25	
2010	1,319,727,750.05	1,642,230,000.00	2,961,957,750.05	
2011	1,233,327,679.84	1,606,564,045.16	2,839,891,725.00	
2012	1,143,481,627.44	1,274,370,000.00	2,417,851,627.44	
2013	1,080,714,958.75	998,135,000.00	2,078,849,958.75	
2014	1,032,310,822.14	923,820,000.00	1,956,130,822.14	
2015	988,011,264.69	878,210,000.00	1,866,221,264.69	
2016	941,943,008.96	782,440,000.00	1,724,383,008.96	
2017	900,778,060.78	782,810,000.00	1,683,588,060.78	
2018	861,210,715.45	788,305,000.00	1,649,515,715.45	
2019	819,803,500.47	891,070,000.00	1,710,873,500.47	
2020	774,490,505.36	965,770,000.00	1,740,260,505.36	
2021	725,911,476.12	927,840,000.00	1,653,751,476.12	
2022	678,391,218.62	1,123,185,000.00	1,801,576,218.62	
2023	620,698,345.32	1,151,965,000.00	1,772,663,345.32	
2024	562,604,688.23	1,072,335,000.00	1,634,939,688.23	
2025	506,623,212.05	1,224,315,000.00	1,730,938,212.05	
2026	445,653,105.61	1,156,160,000.00	1,601,813,105.61	
2027	387,083,019.36	1,174,715,000.00	1,561,798,019.36	
2028	327,011,291.59	1,230,380,000.00	1,557,391,291.59	
2029	264,541,441.25	1,160,115,000.00	1,424,656,441.25	
2030	203,678,634.50	1,290,715,000.00	1,494,393,634.50	
2031	140,107,787.00	938,330,000.00	1,078,437,787.00	
2032	94,212,540.00	820,835,000.00	915,047,540.00	
2033	52,938,288.75	694,390,000.00	747,328,288.75	
2034	18,470,057.50	408,165,000.00	426,635,057.50	
2035	565,200.00	12,560,000.00	13,125,200.00	
Total	**$22,401,032,386.34**	**$31,859,912,123.47**	**$54,260,944,509.81**	

(a) Includes scheduled mandatory sinking fund payments.
(b) Total represents the remaining debt service requirements from May 1, 2005 through June 30, 2005.

SOURCE: State of California, Office of the Treasurer.

SCHEDULE OF DEBT SERVICE REQUIREMENTS
FOR GENERAL FUND NON-SELF LIQUIDATING BONDS
Variable Rate
As of April 1, 2005

Fiscal Year Ending June 30	Current Debt Interest (a)	Principal (b)	Total	
2005	6,876,157.53	0.00	6,876,157.53	(c)
2006	33,282,891.55	0.00	33,282,891.55	
2007	33,371,336.76	0.00	33,371,336.76	
2008	33,682,969.57	0.00	33,682,969.57	
2009	33,244,410.60	0.00	33,244,410.60	
2010	33,194,446.35	0.00	33,194,446.35	
2011	33,282,891.55	0.00	33,282,891.55	
2012	33,324,172.06	0.00	33,324,172.06	
2013	33,680,411.67	0.00	33,680,411.67	
2014	33,371,336.76	0.00	33,371,336.76	
2015	33,282,891.55	0.00	33,282,891.55	
2016	33,176,389.23	67,455,000.00	100,631,389.23	
2017	32,233,071.51	87,885,000.00	120,118,071.51	
2018	31,145,346.11	83,390,000.00	114,535,346.11	
2019	30,320,096.06	77,080,000.00	107,400,096.06	
2020	28,900,901.95	89,250,000.00	118,150,901.95	
2021	27,397,915.48	183,510,000.00	210,907,915.48	
2022	24,968,423.29	97,060,000.00	122,028,423.29	
2023	23,602,451.96	119,800,000.00	143,402,451.96	
2024	21,854,942.85	296,540,000.00	318,394,942.85	
2025	17,461,168.95	201,180,000.00	218,641,168.95	
2026	14,335,811.22	346,030,000.00	360,365,811.22	
2027	9,590,659.22	74,285,000.00	83,875,659.22	
2028	8,663,611.48	77,260,000.00	85,923,611.48	
2029	7,649,088.61	110,350,000.00	117,999,088.61	
2030	6,285,831.51	114,760,000.00	121,045,831.51	
2031	4,747,811.79	119,350,000.00	124,097,811.79	
2032	3,205,480.74	124,125,000.00	127,330,480.74	
2033	1,602,421.11	129,090,000.00	130,692,421.11	
2034	22,282.25	1,600,000.00	1,622,282.25	
Total	**$667,757,621.27**	**$2,400,000,000.00**	**$3,067,757,621.27**	

(a) The estimate of future interest payments is based on rates in effect as of November 1, 2004. The interest rates for the daily, weekly and auction rate bonds range from 1.65 - 1.82%.

(b) Includes scheduled mandatory sinking fund payments.

(c) Total represents the remaining estimated debt service requirements from May 1, 2005 through June 30, 2005.

SOURCE: State of California, Office of the Treasurer.

SCHEDULE OF DEBT SERVICE REQUIREMENTS
FOR ENTERPRISE FUND SELF LIQUIDATING BONDS
Fixed Rate
As of April 1, 2005

Fiscal Year Ending June 30	Current Debt Interest	Principal (a)	Total	
2005	29,605,297.47	7,150,000.00	36,755,297.47	(b)
2006	110,433,031.00	124,300,000.00	234,733,031.00	
2007	101,422,747.26	129,360,000.00	230,782,747.26	
2008	91,600,911.04	136,430,000.00	228,030,911.04	
2009	81,812,643.75	135,340,000.00	217,152,643.75	
2010	72,539,719.05	118,190,000.00	190,729,719.05	
2011	65,209,997.02	86,480,000.00	151,689,997.02	
2012	60,775,254.75	90,895,000.00	151,670,254.75	
2013	56,806,861.87	83,395,000.00	140,201,861.87	
2014	52,774,188.50	97,720,000.00	150,494,188.50	
2015	47,917,828.05	114,260,000.00	162,177,828.05	
2016	42,123,571.90	121,930,000.00	164,053,571.90	
2017	35,895,849.29	129,925,000.00	165,820,849.29	
2018	29,865,583.99	105,035,000.00	134,900,583.99	
2019	24,519,579.11	100,850,000.00	125,369,579.11	
2020	20,506,283.61	52,590,000.00	73,096,283.61	
2021	17,704,637.50	45,615,000.00	63,319,637.50	
2022	15,228,971.25	41,240,000.00	56,468,971.25	
2023	13,480,617.01	21,730,000.00	35,210,617.01	
2024	12,264,105.52	23,025,000.00	35,289,105.52	
2025	10,949,341.91	25,350,000.00	36,299,341.91	
2026	9,740,973.75	18,805,000.00	28,545,973.75	
2027	8,650,135.00	20,645,000.00	29,295,135.00	
2028	7,687,360.00	14,215,000.00	21,902,360.00	
2029	6,741,760.00	19,955,000.00	26,696,760.00	
2030	5,404,392.50	28,100,000.00	33,504,392.50	
2031	3,892,867.50	25,920,000.00	29,812,867.50	
2032	2,395,225.00	27,375,000.00	29,770,225.00	
2033	812,977.50	28,930,000.00	29,742,977.50	
Total	**$1,038,762,712.10**	**$1,974,755,000.00**	**$3,013,517,712.10**	

(a) Includes scheduled mandatory sinking fund payments.
(b) Total represents the remaining debt service requirements from May 1, 2005 through June 30, 2005.

SOURCE: State of California, Office of the Treasurer.

SCHEDULE OF DEBT SERVICE REQUIREMENTS
FOR SPECIAL REVENUE FUND SELF LIQUIDATING BONDS
Fixed Rate
As of April 1, 2005

Fiscal Year Ending June 30	Current Debt			
	Interest	Principal (a)	Total	
2006	334,057,750.00	339,650,000.00	673,707,750.00	(b)
2007	321,933,000.00	359,070,000.00	681,003,000.00	
2008	306,105,625.00	393,925,000.00	700,030,625.00	
2009	286,950,375.00	449,920,000.00	736,870,375.00	
2010	264,435,050.00	506,870,000.00	771,305,050.00	
2011	238,816,012.50	549,060,000.00	787,876,012.50	
2012	210,582,985.00	289,375,000.00	499,957,985.00	
2013	187,930,527.50	612,520,000.00	800,450,527.50	
2014	155,291,928.75	663,665,000.00	818,956,928.75	
2015	119,707,869.27	718,195,000.00	837,902,869.27	
2016	81,873,485.00	776,040,000.00	857,913,485.00	
2017	44,866,155.00	712,225,000.00	757,091,155.00	
2018	13,611,362.50	550,000,000.00	563,611,362.50	
2019	47,500.00	0.00	47,500.00	
2020	47,500.00	0.00	47,500.00	
2021	47,500.00	0.00	47,500.00	
2022	47,500.00	0.00	47,500.00	
2023	47,500.00	0.00	47,500.00	
2024	23,750.00	1,000,000.00	1,023,750.00	
Total	**$2,566,423,375.52**	**$6,921,515,000.00**	**$9,487,938,375.52**	

(a) Includes scheduled mandatory sinking fund payments.
(b) Total represents the remaining debt service requirements from May 1, 2005 through June 30, 2005.

SOURCE: State of California, Office of the Treasurer.

SCHEDULE OF DEBT SERVICE REQUIREMENTS FOR SPECIAL REVENUE FUND SELF LIQUIDATING BONDS
Variable Rate
As of April 1, 2005

Fiscal Year Ending June 30	Current Debt		
	Interest (a)	Principal (b)	Total
2005	$ 5,214,311.67	$ -	$ 5,214,311.67 (c)
2006	71,034,732.37	-	71,034,732.37
2007	71,120,212.89	-	71,120,212.89
2008	68,846,834.86	-	68,846,834.86
2009	63,734,825.66	-	63,734,825.66
2010	61,594,051.85	-	61,594,051.85
2011	61,679,532.37	-	61,679,532.37
2012	61,729,979.89	-	61,729,979.89
2013	62,063,727.60	-	62,063,727.60
2014	61,765,012.89	-	61,765,012.89
2015	61,679,532.37	-	61,679,532.37
2016	61,644,732.92	-	61,644,732.92
2017	59,577,687.11	297,410,000.00	356,987,687.11
2018	48,194,946.41	651,985,000.00	700,179,946.41
2019	27,531,600.03	985,780,000.00	1,013,311,600.03
2020	13,388,538.12	1,018,150,000.00	1,031,538,538.12
2021	4,174,085.30	788,365,000.00	792,539,085.30
2022	283,629.37	226,625,000.00	226,908,629.37
2023	83,577.53	-	83,577.53
2024	21,193.15	6,250,000.00	6,271,193.15
Total	$ 865,362,744.36	$ 3,974,565,000.00	$ 4,839,927,744.36

(a) The estimate of future interest payments is based on rates in effect as of June 30, 2004. The interest rates for the daily and weekly rate bonds range from 1.00-1.12%. $1,000,000,000 of Series 2004B bonds bear interest at fixed rates ranging from 3.00-5.00% until reset dates on July 1, 2007 and July 1, 2008, and are assumed to bear interest at the rate of 3.33% from each reset date to maturity.

(b) Includes scheduled mandatory sinking fund payments.

(c) Total represents the remaining estimated debt service requirements from May 1, 2005 through June 30, 2005.

SOURCE: State of California, Office of the Treasurer.

SCHEDULE OF DEBT SERVICE REQUIREMENTS
FOR LEASE-PURCHASE DEBT
As of April 1, 2005

Fiscal Year Ending June 30	Current Debt			
	Interest	Principal (a)	Total	
2005	118,914,879.67	59,205,000.00	178,119,879.67	(b)
2006	371,156,480.18	397,547,554.60	768,704,034.78	
2007	356,767,598.09	351,498,920.44	708,266,518.53	
2008	336,494,968.35	360,896,787.98	697,391,756.33	
2009	322,622,390.44	383,922,732.44	706,545,122.88	
2010	297,884,328.49	373,636,633.76	671,520,962.25	
2011	267,814,635.18	387,450,000.00	655,264,635.18	
2012	247,940,203.06	372,045,000.00	619,985,203.06	
2013	228,642,835.22	382,200,000.00	610,842,835.22	
2014	208,773,645.84	386,770,000.00	595,543,645.84	
2015	188,232,907.14	406,660,000.00	594,892,907.14	
2016	166,801,181.41	389,575,000.00	556,376,181.41	
2017	145,774,832.42	396,405,000.00	542,179,832.42	
2018	124,901,383.15	412,940,000.00	537,841,383.15	
2019	103,632,123.78	374,015,000.00	477,647,123.78	
2020	84,032,513.44	346,360,000.00	430,392,513.44	
2021	67,167,646.99	284,990,000.00	352,157,646.99	
2022	52,199,393.74	257,715,000.00	309,914,393.74	
2023	40,342,960.37	205,620,000.00	245,962,960.37	
2024	30,669,310.75	117,585,000.00	148,254,310.75	
2025	24,621,980.00	123,635,000.00	148,256,980.00	
2026	18,790,062.50	110,910,000.00	129,700,062.50	
2027	13,087,330.00	116,580,000.00	129,667,330.00	
2028	7,168,868.75	106,845,000.00	114,013,868.75	
2029	2,493,862.50	44,125,000.00	46,618,862.50	
2030	232,843.75	9,345,000.00	9,577,843.75	
Total	**$3,827,161,165.21**	**$7,158,477,629.22**	**$10,985,638,794.43**	

(a) Includes scheduled mandatory sinking fund payments.

(b) Total represents the remaining debt service requirements from May 1, 2005 through June 30, 2005.

SOURCE: State of California, Office of the Treasurer.

STATE PUBLIC WORKS BOARD AND
OTHER LEASE-PURCHASE FINANCING
OUTSTANDING ISSUES
April 1, 2005

Name of Issue	Outstanding
GENERAL FUND SUPPORTED ISSUES:	
State Public Works Board	
California Community Colleges	513,690,000
California Department of Corrections *	2,400,006,019
California Youth Authority	16,305,000
Office of Energy Assessments (a)	62,170,000
The Regents of the University of California (b) *	1,237,081,610
Trustees of the California State University	549,785,000
Various State Office Buildings	1,555,460,000
Total State Public Works Board Issues	**$6,334,497,629**
Total Other State Building Lease Purchase Issues (c)	**$823,980,000**
Total General Fund Supported Issues	**$7,158,477,629**
SPECIAL FUND SUPPORTED ISSUES:	
East Bay State Building Authority *	59,072,547
San Bernardino Joint Powers Financing Authority	51,460,000
San Francisco State Building Authority (d)	35,635,000
Total Special Fund Supported Issues	**$146,167,547**
TOTAL	**$7,304,645,177**

* Includes the initial value of capital appreciation bonds rather than the accreted value.
(a) This program is self-liquidating based on energy cost savings.
(b) The Regents' obligations to the State Public Works Board are payable from lawfully available funds of The Regents which are held in The Regents' treasury funds and are separate from the State General Fund. A portion of The Regents' annual budget is derived from General Fund appropriations.
(c) Includes $180,450,000 Sacramento City Financing Authority Lease Revenue Bonds State of California - Cal EPA Building, 1998 Series A, which are supported by lease rentals from the California Environmental Protection Agency; these rental payments are subject to annual appropriation by the State Legislature.
(d) The sole tenant is the California Public Utilities Commission.

SOURCE: State of California, Office of the Treasurer.

STATE AGENCY REVENUE BONDS
AND CONDUIT FINANCING
As of December 31, 2004

Issuing Agency		Outstanding[(a)(b)]
State Programs Financing:		
California Department of Transportation - GARVEE	$	614,850,000
California Infrastructure and Economic Development Bank [(c)]		1,439,010,000
California Power Authority		26,105,000
California State University		1,032,818,000
Department of Water Resources - Central Valley Project		2,222,255,000
Department of Water Resources - Power Supply Program		6,833,500,000
The Regents of the University of California		4,687,695,000
Housing Financing:		
California Housing Finance Agency		8,006,098,121
Veterans Revenue Debenture		451,210,000
Conduit Financing:		
California Alternative Energy and Advanced Transportation Financing Authority		56,385,000
California Educational Facilities Authority		3,065,775,429
California Health Facilities Financing Authority		5,997,822,178
California Infrastructure and Economic Development Bank [(c)]		3,061,806,788
California Pollution Control Financing Authority		3,944,120,279
California Student Loan Authority		55,460,000
TOTAL	**$**	**41,494,910,795**

[(a)] Totals for California State University, Department of Water Resources, California Power Authority, California Department of Transportation (GARVEE), and Veterans Revenue Debenture were provided by the State of California, Office of the Treasurer. All other totals were provided by the listed issuing agency.
[(b)] Does not include $5.6 Billion of "tobacco settlement revenue bonds" issued by Golden State Tobacco Securitization Corporation.
[(c)] Does not include $6 billion of "rate reduction bonds" issued by special purpose trusts for the benefit of four investor-owned electric utility companies representing interests in certain electric rate surcharges.

STATEMENT of GENERAL FUND CASH RECEIPTS and DISBURSEMENTS

March 2005

STEVE WESTLY
California State Controller

STEVE WESTLY
California State Controller

April 8, 2005

Users of the Statement of General Fund Cash Receipts and Disbursements

Attached are the Statements of General Fund Cash Receipts and Disbursements for the period July 1, 2004 through March 31, 2005. These statements reflect the State of California's General Fund cash position and compare actual receipts and disbursements for the 2004-05 fiscal year to cash flow estimates prepared by the Department of Finance for the 2005-06 Governor's Budget as well as the 2004-05 Budget Act. These statements are prepared in compliance with Government Code section 12461.1, as well as Item 0840-001-0001, Provision 10, of the 2004-05 Budget Act, using records compiled by the State Controller.

Attachment A compares actual receipts and disbursements to date for the 2004-05 fiscal year to cash flow estimates published in the 2005-06 Governor's Budget. The Governor's Budget cash flow reflects an expected increase of $2.1 billion in receipts, and an expected increase of $1.3 billion in disbursements from the Budget Act estimate for the 2004-05 fiscal year. These cash flow estimates are predicated on projections and assumptions made by the Department of Finance in preparation of the Governor's Budget.

Attachment B compares actual receipts and disbursements to date for the 2004-05 fiscal year to cash flow estimates prepared by the Department of Finance based upon the 2004-05 Budget Act. Prior year actual amounts are also displayed for comparative purposes.

These statements are also available on the Internet at the State Controller's website at http://www.sco.ca.gov/ard/state/index.shtml under the category Monthly Statement of General Fund Cash Receipts and Disbursements.

Any questions concerning this report may be directed to Vincent P. Brown, Chief Operating Officer, at (916) 552-8080.

Sincerely,

Steve Westly

STEVE WESTLY
California State Controller

300 Capitol Mall, Suite 1850, Sacramento, CA 95814 ♦ P.O. Box 942850, Sacramento, CA 94250
PHONE: (916) 445-2636 ♦ Fax: (916) 445-6379 ♦ Web Address: www.sco.ca.gov♦ E-Mail: steve@sco.ca.gov

STATEMENT OF GENERAL FUND CASH RECEIPTS AND DISBURSEMENTS
A Comparison of Actual to 2005-06 Governor's Budget Estimates
(Amounts in thousands)
Attachment A

	July 1 through March 31				
	2005				2004
	Actual	Estimate (a)	Actual Over or (Under) Estimate Amount	%	Actual
GENERAL FUND BEGINNING CASH BALANCE	**$ 538,359**	**$ 538,359**	**$ -**	**-**	**$ 438,110**
Add Receipts:					
Revenues	55,195,156	55,029,044	166,112	0.3	51,721,115
Nonrevenues	2,176,398	3,037,741	(861,343)	(28.4)	3,462,935
Total Receipts	57,371,554	58,066,785	(695,231)	(1.2)	55,184,050
Less Disbursements:					
State Operations	15,375,429	15,533,927	(158,498)	(1.0)	13,664,906
Local Assistance	51,871,111	52,435,861	(564,750)	(1.1)	47,845,351
Capital Outlay	59,737	67,164	(7,427)	(11.1)	206,206
Payment to Deficit Recovery Fund	2,012,000	-	2,012,000	-	-
Offsets from Economic Recovery Bonds	(2,012,000)	-	(2,012,000)	-	-
Nongovernmental	(364,996)	685,991	(1,050,987)	(153.2)	2,052,233
Total Disbursements	66,941,281	68,722,943	(1,781,662)	(2.6)	63,768,696
Receipts Over / (Under) Disbursements	(9,569,727)	(10,656,158)	1,086,431	-	(8,584,646)
Net Increase / (Decrease) in Temporary Loans	9,031,368	10,117,799	(1,086,431)	(10.7)	8,146,536
GENERAL FUND ENDING CASH BALANCE	-	-	-	-	-
Special Fund for Economic Uncertainties	-	-	-	-	-
TOTAL CASH	$ -	$ -	$ -	-	$ -

BORROWABLE RESOURCES

	Actual	Estimate (a)	Amount	%	Actual
Available Borrowable Resources	$ 15,758,779	$ 13,752,812	$ 2,005,967	14.6	$ 23,645,945
Outstanding Loans (b)	9,031,368	10,117,799	(1,086,431)	(10.7)	19,111,536
Unused Borrowable Resources	$ 6,727,411	$ 3,635,013	$ 3,092,398	85.1	$ 4,534,409

General Note:
This report is based upon funded cash. Funded cash is cash reported to and recorded in the records of the State Controller's Office. Amounts reported as funded cash may differ from amounts in other reports to the extent there are timing differences in the recording of in-transit items.

Footnotes:
(a) A Statement of Estimated Cash Flow for the 2004-05 fiscal year prepared by the Department of Finance for the 2005-06 Governor's Budget. Any projections or estimates are set forth as such and not as representations of fact.
(b) Cumulative loan balance of $9.0 billion is comprised of $3.0 billion in internal borrowing and $6.0 billion in external borrowing.
(c) Negative balances are the result of repayments received that are greater than disbursements made.
(d) Includes Technology, Trade and Commerce that was previously displayed separately and abolished on January 1, 2004
(e) Includes School Facility Aid Program that was previously displayed separately.

SCHEDULE OF CASH RECEIPTS
(Amounts in thousands)

	Month of March		July 1 through March 31				
			2005				2004
	2005	2004	Actual	Estimate (a)	Actual Over or (Under) Estimate Amount	%	Actual
REVENUES							
Alcoholic Beverage Excise Tax	$ 24,735	$ 20,891	$ 234,007	$ 228,009	$ 5,998	2.6	$ 235,386
Corporation Tax	1,792,122	1,153,056	6,237,412	5,913,452	323,960	5.5	4,424,681
Cigarette Tax	7,662	11,018	86,511	87,646	(1,135)	(1.3)	86,899
Estate, Inheritance, and Gift Tax	26,210	46,708	368,111	339,570	28,541	8.4	441,450
Insurance Companies Tax	71,617	51,271	1,116,805	1,373,330	(256,525)	(18.7)	985,858
Personal Income Tax	1,490,601	1,245,998	27,470,589	27,163,011	307,578	1.1	24,421,873
Retail Sales and Use Taxes	1,972,793	2,143,974	18,279,274	18,433,401	(154,127)	(0.8)	17,654,060
Pooled Money Investment Interest	15,033	3,269	104,005	131,803	(27,798)	(21.1)	81,665
Not Otherwise Classified	88,919	100,218	1,298,442	1,358,822	(60,380)	(4.4)	3,389,243
Total Revenues	**5,489,692**	**4,776,403**	**55,195,156**	**55,029,044**	**166,112**	**0.3**	**51,721,115**
NONREVENUES							
Transfers from Special Fund for Economic Uncertainties	-	-	1,448,000	2,216,023	(768,023)	(34.7)	2,524,497
Transfers from Other Funds	4,758	84,947	315,545	432,000	(116,455)	(27.0)	578,544
Miscellaneous	9,741	7,969	412,853	389,718	23,135	5.9	359,894
Total Nonrevenues	**14,499**	**92,916**	**2,176,398**	**3,037,741**	**(861,343)**	**(28.4)**	**3,462,935**
Total Receipts	**$ 5,504,191**	**$ 4,869,319**	**$ 57,371,554**	**$ 58,066,785**	**$ (695,231)**	**(1.2)**	**$ 55,184,050**

See notes on page 1.

SCHEDULE OF CASH DISBURSEMENTS
(Amounts in thousands)

	Month of March		July 1 through March 31			
			2005				2004
					Actual Over or (Under) Estimate		
	2005	2004	Actual	Estimate (a)	Amount	%	Actual
STATE OPERATIONS (c)							
Legislative/Judicial/Executive	$ 82,973	$ 109,791	$ 1,044,594	$ 942,055	$ 102,539	10.9	$ 1,025,395
State and Consumer Services	39,138	37,600	374,249	398,907	(24,658)	(6.2)	362,291
Business, Transportation and Housing	(453)	(286)	4,348	4,511	(163)	(3.6)	5,972
Resources	45,686	27,545	679,279	660,150	19,129	2.9	660,107
CA Environmental Protection Agency	1,328	4,361	31,854	42,462	(10,608)	(25.0)	63,288
Health and Human Services:							
Health Services	32,851	(13,965)	236,506	215,589	20,917	9.7	210,493
Mental Health Hospitals	38,003	26,749	461,631	519,790	(58,159)	(11.2)	416,702
Other Health and Human Services	31,238	30,935	461,466	486,190	(24,724)	(5.1)	540,318
Education:							
University of California	272,077	280,968	2,343,024	2,307,429	35,595	1.5	2,586,534
State Universities and Colleges	192,575	200,523	1,719,337	1,805,737	(86,400)	(4.8)	1,906,019
Other Education	1,144	8,663	109,722	109,458	264	0.2	118,591
Corrections and Youth Authority	524,285	502,583	4,746,508	4,798,865	(52,357)	(1.1)	3,636,958
General Government (d)	87,068	94,961	948,137	971,911	(23,774)	(2.4)	904,077
Public Employees Retirement System	(137,056)	(116,130)	(61,250)	(17,416)	(43,834)	-	(145,777)
Debt Service	246,264	171,801	2,339,371	2,356,860	(17,489)	(0.7)	1,372,728
Interest on Loans	5,168	11,913	(63,347)	(68,571)	5,224	-	1,210
Total State Operations	**1,462,289**	**1,378,012**	**15,375,429**	**15,533,927**	**(158,498)**	**(1.0)**	**13,664,906**
LOCAL ASSISTANCE (c)							
Public Schools - K-12	1,920,808	1,807,999	25,157,974	26,200,023	(1,042,049)	(4.0)	22,067,465
CA Community Colleges	236,966	179,893	2,601,441	2,431,113	170,328	7.0	1,824,506
Contributions to State Teachers' Retirement System	-	-	1,000,163	1,000,162	1	-	397,039
Other Education (e)	153,183	59,319	2,039,635	1,701,263	338,372	19.9	2,061,015
Corrections and Youth Authority	765	5,566	211,978	135,521	76,457	56.4	113,869
Dept. of Alcohol and Drug Program	4,460	12,144	206,340	208,267	(1,927)	(0.9)	189,878
Dept. of Health Services:							
Medical Assistance Program	1,258,137	981,971	8,782,599	8,810,924	(28,325)	(0.3)	8,126,968
Other Health Services	56,090	42,859	395,038	295,578	99,460	33.6	319,384
Dept. of Developmental Services	240,998	124,831	1,576,380	1,451,360	125,020	8.6	1,414,332
Dept. of Mental Health	18,002	76,754	272,331	288,476	(16,145)	(5.6)	402,872
Dept. of Social Services:							
SSI/SSP/IHSS	200,790	(616,522)	3,890,093	3,952,078	(61,985)	(1.6)	3,203,225
CalWORKs	114,396	190,041	2,166,919	2,409,367	(242,448)	(10.1)	2,513,973
Other Social Services	92,591	62,532	935,894	878,962	56,932	6.5	839,189
Tax Relief	6,582	607,635	440,179	454,488	(14,309)	(3.1)	2,122,833
Other Local Assistance	76,430	278,165	2,194,147	2,218,279	(24,132)	(1.1)	2,248,803
Total Local Assistance	**4,380,198**	**3,813,187**	**51,871,111**	**52,435,861**	**(564,750)**	**(1.1)**	**47,845,351**

See notes on page 1.

(Continued)

SCHEDULE OF CASH DISBURSEMENTS (Continued)
(Amounts in thousands)

	Month of March		July 1 through March 31				
			2005				2004
					Actual Over or (Under) Estimate		
	2005	2004	Actual	Estimate (a)	Amount	%	Actual
CAPITAL OUTLAY	**5,847**	**(2,771)**	**59,737**	**67,164**	**(7,427)**	**(11.1)**	**206,206**
PAYMENT TO DEFICIT RECOVERY FUND	**-**	**-**	**2,012,000**	**-**	**2,012,000**	**-**	**-**
OFFSETS FROM ECONOMIC RECOVERY BONDS	**-**	**-**	**(2,012,000)**	**-**	**(2,012,000)**	**-**	**-**
NONGOVERNMENTAL (c)							
Transfer to Special Fund for Economic Uncertainties	-	-	-	768,000	(768,000)	(100.0)	2,216,000
Transfer to Other Funds	1,344	52,517	91,958	321,071	(229,113)	(71.4)	297,636
Transfer to Revolving Fund	(4,773)	19	67,825	81,515	(13,690)	(16.8)	2,906
Advance:							
State-County Property Tax Administration Program	-	-	-	-	-	-	-
Social Welfare Federal Fund	(370)	12,400	(24,344)	14,940	(39,284)	(262.9)	5,550
Tax Relief and Refund Account	-	6,600	-	900	(900)	(100.0)	10,600
Counties for Social Welfare	-	-	(500,435)	(500,435)	-	-	(480,459)
Total Nongovernmental	**(3,799)**	**71,536**	**(364,996)**	**685,991**	**(1,050,987)**	**(153.2)**	**2,052,233**
Total Disbursements	**5,844,535**	**$ 5,259,964**	**$ 66,941,281**	**$ 68,722,943**	**$ (1,781,662)**	**(2.6)**	**$ 63,768,696**
TEMPORARY LOANS							
Special Fund for Economic Uncertainties	-	$ -	$ 766,572	$ 768,000	$ (1,428)	(0.2)	$ 2,216,023
Other Internal Sources	340,344	390,645	2,264,796	3,349,799	(1,085,003)	(32.4)	2,930,513
Revenue Anticipation Notes	-	-	6,000,000	6,000,000	-	-	3,000,000
Net Increase / (Decrease) Loans	**340,344**	**$ 390,645**	**$ 9,031,368**	**$ 10,117,799**	**$ (1,086,431)**	**(10.7)**	**$ 8,146,536**

See notes on page 1.

(Concluded)

COMPARATIVE STATEMENT OF REVENUES RECEIVED
All Governmental Cost Funds
(Amounts in thousands)

	July 1 through March 31			
	General Fund		Special Funds	
	2005	2004	2005	2004
MAJOR TAXES, LICENSES, AND INVESTMENT INCOME:				
Alcoholic Beverage Excise Taxes	$ 234,007	$ 235,386	$ -	$ -
Corporation Tax	6,237,412	4,424,681	-	9
Cigarette Tax	86,511	86,899	716,560	711,686
Estate, Inheritance, and Gift Tax	368,111	441,450	-	-
Insurance Companies Tax	1,116,805	985,858	-	-
Motor Vehicle Fuel Tax:				
Gasoline Tax	-	-	2,167,122	2,112,911
Diesel & Liquid Petroleum Gas	-	-	390,448	387,938
Jet Fuel Tax	-	-	1,932	1,529
Vehicle License Fees	-	-	1,582,357	1,473,819
Motor Vehicle Registration and Other Fees	-	-	2,016,805	1,716,441
Personal Income Tax	27,470,589	24,421,873	62,340	258
Retail Sales and Use Taxes	18,279,274	17,654,060	4,862,876	3,514,396
Pooled Money Investment Interest	104,005	81,665	118	95
Total Major Taxes, Licenses, and Investment Income	**53,896,714**	**48,331,872**	**11,800,558**	**9,919,082**
NOT OTHERWISE CLASSIFIED:				
Alcoholic Beverage License Fee	2,227	1,724	33,382	31,071
Electrical Energy Tax	-	-	394,545	366,494
Private Rail Car Tax	6,561	6,637	-	-
Penalties on Traffic Violations	-	-	59,355	54,786
Health Care Receipts	7,943	11,432	-	-
Revenues from State Lands	145,507	57,528	500	7,903
Abandoned Property	606,525	514,417	-	-
Trial Court Revenues	41,693	31,423	773,002	693,895
Horse Racing Fees	1,883	1,731	25,929	28,141
Miscellaneous	486,103	2,764,351	5,327,822	4,629,678
Not Otherwise Classified	**1,298,442**	**3,389,243**	**6,614,535**	**5,811,968**
Total Revenues, All Governmental Cost Funds	**$ 55,195,156**	**$ 51,721,115**	**$ 18,415,093**	**$ 15,731,050**

STATEMENT OF GENERAL FUND CASH RECEIPTS AND DISBURSEMENTS
A Comparison of Actual to 2004-05 Budget Act Estimates
(Amounts in thousands)
Attachment B

	July 1 through March 31				
	2005				2004
	Actual	Estimate (a)	Actual Over or (Under) Estimate: Amount	%	Actual
GENERAL FUND BEGINNING CASH BALANCE	**$ 538,359**	**$ 538,359**	**$ -**	**-**	**$ 438,110**
Add Receipts:					
Revenues	55,195,156	53,055,000	2,140,156	4.0	51,721,115
Nonrevenues	2,176,398	3,071,582	(895,184)	(29.1)	3,462,935
Total Receipts	57,371,554	56,126,582	1,244,972	2.2	55,184,050
Less Disbursements:					
State Operations	15,375,429	15,252,258	123,171	0.8	13,664,906
Local Assistance	51,871,111	52,694,776	(823,665)	(1.6)	47,845,351
Capital Outlay	59,737	38,056	21,681	57.0	206,206
Payment to Deficit Recovery Fund	2,012,000	2,012,000	-	-	-
Offsets from Economic Recovery Bonds & Punitive Damages	(2,012,000)	(2,237,000)	225,000	-	-
Nongovernmental	(364,996)	658,737	(1,023,733)	(155.4)	2,052,233
Total Disbursements	66,941,281	68,418,827	(1,477,546)	(2.2)	63,768,696
Receipts Over / (Under) Disbursements	(9,569,727)	(12,292,245)	2,722,518	-	(8,584,646)
Net Increase / (Decrease) in Temporary Loans	9,031,368	11,753,886	(2,722,518)	(23.2)	8,146,536
GENERAL FUND ENDING CASH BALANCE	-	-	-	-	-
Special Fund for Economic Uncertainties	-	-	-	-	-
TOTAL CASH	$ -	$ -	$ -	-	$ -

BORROWABLE RESOURCES

	2005 Actual	2005 Estimate (a)	Amount	%	2004 Actual
Available Borrowable Resources	$ 15,758,779	$ 14,334,861	$ 1,423,918	9.9	$ 23,645,945
Outstanding Loans (b)	9,031,368	11,753,886	(2,722,518)	(23.2)	19,111,536
Unused Borrowable Resources	$ 6,727,411	$ 2,580,975	$ 4,146,436	160.7	$ 4,534,409

General Note:
This report is based upon funded cash. Funded cash is cash reported to and recorded in the records of the State Controller's Office. Amounts reported as funded cash may differ from amounts in other reports to the extent there are timing differences in the recording of in-transit items.

Footnotes:
(a) A Statement of Estimated Cash Flow for the 2004-05 fiscal year prepared by the Department of Finance for the Budget Act of 2004. Any projections or estimates are set forth as such and not as representations of fact.
(b) Cumulative loan balance of $9.0 billion is comprised of $3.0 billion in internal borrowing and $6.0 billion in external borrowing.
(c) Negative balances are the result of repayments received that are greater than disbursements made.
(d) Includes Technology, Trade and Commerce that was previously displayed separately and abolished on January 1, 2004
(e) Includes School Facility Aid Program that was previously displayed separately.

SCHEDULE OF CASH RECEIPTS
(Amounts in thousands)

	Month of March		July 1 through March 31					
			2005				2004
	2005	2004	Actual	Estimate (a)	Actual Over or (Under) Estimate Amount	%	Actual
REVENUES							
Alcoholic Beverage Excise Tax	$ 24,735	$ 20,891	$ 234,007	$ 229,000	$ 5,007	2.2	$ 235,386
Corporation Tax	1,792,122	1,153,056	6,237,412	4,552,000	1,685,412	37.0	4,424,681
Cigarette Tax	7,662	11,018	86,511	89,000	(2,489)	(2.8)	86,899
Estate, Inheritance, and Gift Tax	26,210	46,708	368,111	268,000	100,111	37.4	441,450
Insurance Companies Tax	71,617	51,271	1,116,805	1,344,000	(227,195)	(16.9)	985,858
Personal Income Tax	1,490,601	1,245,998	27,470,589	26,593,000	877,589	3.3	24,421,873
Retail Sales and Use Taxes	1,972,793	2,143,974	18,279,274	18,433,000	(153,726)	(0.8)	17,654,060
Pooled Money Investment Interest	15,033	3,269	104,005	118,000	(13,995)	(11.9)	81,665
Not Otherwise Classified	88,919	100,218	1,298,442	1,429,000	(130,558)	(9.1)	3,389,243
Total Revenues	**5,489,692**	**4,776,403**	**55,195,156**	**53,055,000**	**2,140,156**	**4.0**	**51,721,115**
NONREVENUES							
Transfers from Special Fund for Economic Uncertainties	-	-	1,448,000	2,216,023	(768,023)	(34.7)	2,524,497
Transfers from Other Funds	4,758	84,947	315,545	535,188	(219,643)	(41.0)	578,544
Miscellaneous	9,741	7,969	412,853	320,371	92,482	28.9	359,894
Total Nonrevenues	**14,499**	**92,916**	**2,176,398**	**3,071,582**	**(895,184)**	**(29.1)**	**3,462,935**
Total Receipts	**$ 5,504,191**	**$ 4,869,319**	**$ 57,371,554**	**$ 56,126,582**	**$ 1,244,972**	**2.2**	**$ 55,184,050**

See notes on page 1.

SCHEDULE OF CASH DISBURSEMENTS
(Amounts in thousands)

	Month of March		July 1 through March 31				
			2005				2004
	2005	2004	Actual	Estimate (a)	Actual Over or (Under) Estimate Amount	%	Actual
STATE OPERATIONS (c)							
Legislative/Judicial/Executive	$ 82,973	$ 109,791	$ 1,044,594	$ 904,265	$ 140,329	15.5	$ 1,025,395
State and Consumer Services	39,138	37,600	374,249	403,493	(29,244)	(7.2)	362,291
Business, Transportation and Housing	(453)	(286)	4,348	3,707	641	17.3	5,972
Resources	45,686	27,545	679,279	561,234	118,045	21.0	660,107
Environmental Protection Agency	1,328	4,361	31,854	44,938	(13,084)	(29.1)	63,288
Health and Human Services:							
Health Services	32,851	(13,965)	236,506	225,568	10,938	4.8	210,493
Mental Health Hospitals	38,003	26,749	461,631	536,142	(74,511)	(13.9)	416,702
Other Health and Human Services	31,238	30,935	461,466	495,286	(33,820)	(6.8)	540,318
Education:							
University of California	272,077	280,968	2,343,024	2,287,714	55,310	2.4	2,586,534
State Universities and Colleges	192,575	200,523	1,719,337	1,806,801	(87,464)	(4.8)	1,906,019
Other Education	1,144	8,663	109,722	115,859	(6,137)	(5.3)	118,591
Corrections and Youth Authority	524,285	502,583	4,746,508	4,550,723	195,785	4.3	3,636,958
General Government (d)	87,068	94,961	948,137	984,733	(36,596)	(3.7)	904,077
Public Employees Retirement System	(137,056)	(116,130)	(61,250)	(72,479)	11,229	-	(145,777)
Debt Service	246,264	171,801	2,339,371	2,398,928	(59,557)	(2.5)	1,372,728
Interest on Loans	5,168	11,913	(63,347)	5,346	(68,693)	(1,284.9)	1,210
Total State Operations	**1,462,289**	**1,378,012**	**15,375,429**	**15,252,258**	**123,171**	**0.8**	**13,664,906**
LOCAL ASSISTANCE (c)							
Public Schools - K-12	1,920,808	1,807,999	25,157,974	26,094,004	(936,030)	(3.6)	22,067,465
Community Colleges	236,966	179,893	2,601,441	2,436,992	164,449	6.7	1,824,506
Contributions to State Teachers' Retirement System	-	-	1,000,163	1,032,862	(32,699)	(3.0)	397,039
Other Education (e)	153,183	59,319	2,039,635	1,868,506	171,129	9.2	2,061,015
Corrections and Youth Authority	765	5,566	211,978	133,459	78,519	58.8	113,869
Dept. of Alcohol and Drug Program	4,460	12,144	206,340	213,691	(7,351)	(3.4)	189,878
Dept. of Health Services:							
Medical Assistance Program	1,258,137	981,971	8,782,599	8,933,728	(151,129)	(1.7)	8,126,968
Other Health Services	56,090	42,859	395,038	288,586	106,452	36.9	319,384
Dept. of Developmental Services	240,998	124,831	1,576,380	1,648,160	(71,780)	(4.4)	1,414,332
Dept. of Mental Health	18,002	76,754	272,331	311,908	(39,577)	(12.7)	402,872
Dept. of Social Services:							
SSI/SSP/IHSS	200,790	(616,522)	3,890,093	3,947,647	(57,554)	(1.5)	3,203,225
CalWORKs	114,396	190,041	2,166,919	2,406,775	(239,856)	(10.0)	2,513,973
Other Social Services	92,591	62,532	935,894	793,407	142,487	18.0	839,189
Tax Relief	6,582	607,635	440,179	428,758	11,421	2.7	2,122,833
Other Local Assistance	76,430	278,165	2,194,147	2,156,293	37,854	1.8	2,248,803
Total Local Assistance	**4,380,198**	**3,813,187**	**51,871,111**	**52,694,776**	**(823,665)**	**(1.6)**	**47,845,351**

See notes on page 1.

(Continued)

SCHEDULE OF CASH DISBURSEMENTS (Continued)
(Amounts in thousands)

	Month of March		July 1 through March 31				
			2005				2004
	2005	2004	Actual	Estimate (a)	Actual Over or (Under) Estimate Amount	%	Actual
CAPITAL OUTLAY	**5,847**	**(2,771)**	**59,737**	**38,056**	**21,681**	**57.0**	**206,206**
PAYMENT TO DEFICIT RECOVERY FUND	**-**	**-**	**2,012,000**	**2,012,000**	**-**	**-**	**-**
OFFSETS FROM ECONOMIC RECOVERY BONDS & PUNITIVE DAMAGES	**-**	**-**	**(2,012,000)**	**(2,237,000)**	**225,000**	**-**	**-**
NONGOVERNMENTAL (c)							
Transfer to Special Fund for Economic Uncertainties	-	-	-	768,000	(768,000)	(100.0)	2,216,000
Transfer to Other Funds	1,344	52,517	91,958	352,906	(260,948)	(73.9)	297,636
Transfer to Revolving Fund	(4,773)	19	67,825	-	67,825	-	2,906
Advance:							
State-County Property Tax Administration Program	-	-	-	-	-	-	-
Social Welfare Federal Fund	(370)	12,400	(24,344)	-	(24,344)	-	5,550
Tax Relief and Refund Account	-	6,600	-	-	-	-	10,600
Counties for Social Welfare	-	-	(500,435)	(462,169)	(38,266)	-	(480,459)
Total Nongovernmental	**(3,799)**	**71,536**	**(364,996)**	**658,737**	**(1,023,733)**	**(155.4)**	**2,052,233**
Total Disbursements	**5,844,535**	**$ 5,259,964**	**$ 66,941,281**	**$ 68,418,827**	**$ (1,477,546)**	**(2.2)**	**$ 63,768,696**
TEMPORARY LOANS							
Special Fund for Economic Uncertainties	-	$ -	$ 766,572	$ 768,000	$ (1,428)	(0.2)	$ 2,216,023
Other Internal Sources	340,344	390,645	2,264,796	4,985,886	(2,721,090)	(54.6)	2,930,513
Revenue Anticipation Notes	-	-	6,000,000	6,000,000	-	-	3,000,000
Net Increase / (Decrease) Loans	**340,344**	**$ 390,645**	**$ 9,031,368**	**$ 11,753,886**	**$ (2,722,518)**	**(23.2)**	**$ 8,146,536**

See notes on page 1.

(Concluded)

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APPENDIX B
THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND

This APPENDIX B includes information about the Department, its Program, the 1943 Fund (including audited financial statements) and the Department's allocation of receipts from Contracts of Purchase, including Excess Revenues.

THE DEPARTMENT

General

In 1921, the California Legislature created the Veterans' Welfare Board and the Program. The Department of Veterans Affairs became the successor to the Veterans' Welfare Board under the Farm and Home Purchase Act of 1943. The Department is a subdivision of the State and constitutes a public corporation. One of the Department's basic objectives is to provide eligible veterans the opportunity to acquire homes with long-term low-interest financing provided under the Program.

The California Veterans Board ("Board") determines the policies for all operations of the Department. The Board is composed of seven members appointed by the Governor, subject to Senate confirmation, for respective terms of four years except that the member of the Board who is a resident of a California veterans home shall have a two year term. All of the members of the Board must be veterans, one member must be retired from the active or reserve forces of the United States military service, one member must have substantial training or professional expertise in mortgage lending and real estate finance, one member must have substantial training or professional expertise in geriatrics, gerontology, or long-term care, and one member must be a resident of one of the California veterans homes run by the Department established for qualified aged and disabled veterans and their spouses. There are presently two vacancies on the Board.

There are four principal divisions within the Department: the Division of Veterans Services, the Division of Administration, the Veterans' Home Division and the Division of Farm and Home Purchases. The Program is administered by the Division of Farm and Home Purchases with support from the Division of Administration and other Department support units. See "THE PROGRAM."

Administration

In addition to its headquarters in Sacramento, the Division of Farm and Home Purchases maintains field offices located throughout the State. These local offices, in addition to providing information to all veterans concerning the Program, are responsible for Contract of Purchase originations and the initial collection and evaluation of data regarding applicants for the Program and the properties to be acquired under the Program. This includes examinations as to the qualification of veterans to participate in the Program, a credit analysis for each applicant, ordering appraisals of properties and the initial processing of the veterans' applications for Contracts of Purchase. Field offices handle the complete loan processing for construction loans and also handle overflow from the Sacramento headquarters when volume is high.

Final processing and servicing of the Contracts of Purchase are performed by the Department at its headquarters and entail Contract of Purchase accounting, insurance and property damage claims adjustment and services, Contract of Purchase alterations and contract performance services. The Department allows certain specially-trained and certified mortgage brokers to originate Contracts of Purchase. All Contracts of Purchase are serviced by the Department. The Department uses an integrated loan processing and financial information system ("Mitas") for origination and servicing of all Contracts of Purchase. General administration of the Program, including fiscal, legal, personnel and other administrative functions, is also performed at the Department's headquarters. As of February 28, 2005, the Department had a staff of approximately 155 persons in support of the Program.

The Secretary and other staff personnel of the Department principally responsible for the administration of the Program are listed below. The Secretary is appointed by the Governor of the State, serves at the pleasure of the Governor and must be a veteran.

Thomas Johnson, FACHE
Secretary since February 2004

A Vietnam Era Veteran with more than 34 years in healthcare management experience, Mr. Johnson is a graduate of the University of Minnesota and holds a Masters Degree in public health from the University of California, Los Angeles. His knowledge of healthcare finance and management began with his service in the Medical Service Corps branch of the United States Army. He managed a 600-bed hospital and acted as commanding officer for Army patients dislocated from their units in Vietnam. Upon his return from overseas deployment and discharge from the Army, Mr. Johnson served for 31 years as a hospital administrator in Tulare County, first at Tulare District Hospital and later at Kaweah Delta District Hospital in Visalia. Since 2001, Mr. Johnson has served as a consultant to The California Endowment and to several health care organizations. Mr. Johnson is a Life Fellow with the American College of Healthcare Executives and is the board chair of the California Institute for Nursing and Healthcare. An active member in his community, Mr. Johnson has been involved with a great variety of local, state and federal groups.

Roger L. Brautigan
Undersecretary since June 2004

Mr. Brautigan is a 33-year veteran of the U.S. Army, achieving the rank of Major General while serving in a variety of active and reserve command and staff positions in the United States, Vietnam and Germany. His command assignments ranged from Platoon leader to both company and battalion level commands. Most recently he served as deputy commanding general and chief of staff, I Corps and Fort Lewis in Fort Lewis, WA. Mr. Brautigan holds a Bachelor of Science degree from the University of Arizona at Tucson and a Master's degree from the University of the Pacific at Stockton, California. He is a graduate of the Armor, Infantry, and Adjutant General Officer Advanced Courses, Army Command and General Staff College, and the Army War College. Mr. Brautigan's military awards and decorations include the Defense Distinguished Service Medal, the Distinguished Service Medal, the Legion of Merit (with oak leaf cluster), the Bronze Star Medal, the Defense Meritorious Service Medal, the Meritorious Service Medal (with 3 oak leaf clusters), the Army Commendation Medal (with 3 oak leaf clusters), the Army Achievement Medal (with oak leaf cluster), various service and unit awards, and the Army General Staff Identification Badge.

Robert Udall Glazier
Deputy Secretary since March 2004

Mr. Glazier has 20 years of experience in corporate and political communications, with an emphasis on public policy. He was appointed as Deputy Secretary of Veterans Affairs by Governor Schwarzenegger in March of 2004. Mr. Glazier received his Bachelor of Arts degree in political science from Brigham Young University and his Juris Doctorate Degree from South Texas College of Law, where he was on the Dean's List and received the American Jurisprudence Award for Constitutional Law. He is an attorney licensed in both Texas and Utah.

Sheryl A. Schmidt
Deputy Secretary since November 1996

After leaving the accounting firm of Touche Ross (now known as Deloitte & Touche LLP) in 1987, Deputy Secretary Schmidt began her state career at the State Controller's Office as a Certified Public Accountant (CPA). In 1995, she accepted the newly created position of Chief of Audits at the Department and developed the Internal Audit Division. In 1996, the Governor of California appointed United States Air Force veteran Sheryl Schmidt as the Deputy Secretary of Women Veterans Affairs. Ms. Schmidt holds a Bachelor's degree in management from St. Leo's College in Florida, a Master's of Business Administration (MBA) from California State University, Sacramento, and a CPA license from the California State Board of Accountancy.

John Hanretty
Director of Operations since August 2004

Mr. Hanretty is a United States Air Force, Vietnam-era veteran who graduated from California State University, Sacramento in 1975 with a degree in Government. After graduation, he worked for eight years in the California Department of Health Services regulating Prepaid Health Plans for Medicaid clients. He then spent twelve years in management positions with private health maintenance organizations in Arizona and California rising to the level of Chief Executive Officer. His responsibilities included sales, medical management, provider staffing, member services, contracting, financial accounting and budgeting. He returned to State government service in 1994 as a Budget Manager. Mr. Hanretty served as the Budget Officer for the Department from August 1998 until September 1999, was Chief, Administrative Services Division from September 1999 until July 2004, and was appointed Director of Operations in August 2004. He has continuously served on community non-profit boards of directors during his professional career.

John F. Jackson
Acting Chief Counsel of Legal Affairs since March 2005

John F. Jackson received a Bachelor of Arts degree from Baylor University in 1955 with a double major in English and History. Following his graduation from Baylor, he entered the United States Navy and served as an Airborne CIC Officer. During his tour in the Navy, he was able to attend the University of San Francisco where he obtained a J. D. degree in 1963. In 1965, after working two years for Travelers Insurance Company as a supervising adjuster, Mr. Jackson opened a law office in Sunnyvale, California where he practiced for the next 35 years. He was president of the Sunnyvale, Cupertino Bar Association and an arbitrator for the American Bar Association and the Superior Court of the County of Santa Clara. During this time, he also taught Civil Procedure, Torts and Constitutional Law at De Anza College in Cupertino, California, in the Administration of Justice/Para-Legal Program for over 12 years and was selected by his students to Who's Who Among American Teachers. Mr. Jackson has been with the Department since January 2001.

Debra Lehr
Chief, Farm and Home Purchases Division since July 2003

Ms. Lehr brings more than 30 years of Cal-Vet program experience to the position of Division Chief. Her responsibilities have included loan origination, appraisal, underwriting, legal, marketing, collections and foreclosure functions. Since 1995, she has held the positions of Foreclosure/REO Unit Manager, Loan Servicing Operations Manager, and Assistant Division Chief with oversight of all loan-servicing functions, and was responsible for the successful centralization and reengineering of the program's delinquent account, foreclosure and REO processes. Ms. Lehr was appointed Division Chief July 2003.

Weijian Ni
Chief, Bond Finance Division since March 2004

Mr. Ni brings to his current position more than 10 years of service of financial analysis and management in the California State government. Since joining the Department in 1996, Mr. Ni has held various analyst and management positions in Bond Finance and Accounting. Mr. Ni holds a Master's degree in Business Administration (MBA) from California State University, Sacramento.

External Review of the Program

The Program and the Department have been the subject of several external reviews by the executive and legislative branches of State government. A summary of certain of these reviews is presented below.

The Legislative Analyst's Office of the State of California

The Legislative Analyst's Office of the State of California (the "LAO"), issued a report in 1998 entitled "Rethinking the Cal-Vet Loan Program" (the "1998 Report"), and an analysis of the then-proposed Governor's Budget 1999/2000, which analysis included a discussion of the Department (the "1999 Report" and, together with the 1998 Report, the "1998/99 LAO Reports.") The stated purpose of the LAO is to provide analysis and nonpartisan advice to the California Legislature on fiscal and policy issues. The LAO is overseen by the Joint Legislative Budget Committee, a 14-member bipartisan committee composed of an equal number of State Assembly and State Senate members.

In the 1998/99 LAO Reports, the LAO analyzed the historical and financial performance and lending activities of the Department and made various recommendations. The 1998/99 LAO Reports described the financial losses experienced by the Department, the increasing rate of repayment of Contracts of Purchase, and the decreased lending activity in recent years. The 1998/99 LAO Reports were issued before the impact of the Department's 1997/98 programmatic changes had been realized.

On February 17, 2000, the LAO issued an analysis of the proposed Governor's Budget for Fiscal Year 2000-01, which analysis included a discussion of the Department. The report recognized that the administrative costs of the Program are not part of the State budget, but recommended that the Department report to the State Legislature during budget hearings on the reasons for certain cost increases and the steps it is taking to reduce such costs. The LAO did not address the Program, Veterans G.O. Bonds, Revenue Bonds, or the 1943 Fund (defined below) in its reports on the Governor's Budget for Fiscal Year 2001-2002 or thereafter.

Bureau of State Audits

On May 25, 2000, the Bureau of State Audits ("BSA") released an audit report concluding that the loan program will substantially lose its ability to offer low-cost home loans to veterans beyond the next decade due to the restrictive eligibility requirements attributed to certain program funding and the limited availability of other funding sources. The BSA further concluded that the Department was eroding loan program funds due to insufficient budget controls, inefficient and inconsistent loan operations and by charges to the loan program for unrelated administrative positions and costs. Finally, the BSA concluded, based in part upon its conclusion that the Department's testing of its integrated information system was incomplete, that the Department will need to spend more time and money to ensure that its integrated information system provides necessary, reliable program and financial information. The Department disagreed with certain conclusions of the BSA and expressed the belief that it had already addressed certain report findings.

On March 28, 2001, the BSA released an audit report prepared in response to the Legislature's direction for an audit of the Department's life and disability insurance program. The programs that were examined by the audit report are no longer in place. See "THE PROGRAM – Property and Life and Disability Insurance" and APPENDIX C – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA."

Copies of the 1998/99 LAO Reports and the May 25, 2000 and March 28, 2001 reports of the BSA, including the Department's responses thereto, are available from the Department upon request.

In June 2003 the BSA released its report pertaining to the Board and to the Department's responses to recommendations in prior audits. The audit concludes among other things that (i) the Board has not established itself as an effective policy-maker for the Department; (ii) the Board lacks independent counsel to minimize the legal risks of its policy-making and appeals actions; (iii) the Board's appeal process needs improvement to ensure that veterans' appeals are handled consistently and appropriately; (iv) the Board's effectiveness is hindered by its reduced membership and lack of training on its responsibilities; and (v) although the Department has implemented eight of the fourteen recommendations that were reviewed from previous BSA audits, it has not given sufficient attention to the projected decrease in the number of veterans who will be eligible for QVMB-backed loans which could affect the long-term viability of the Program.

In written responses to the June 2003 audit, the Board and the Department responded to all of the audit's conclusions. With respect to the point made in (i) above, the Board stated that it will develop action plans based on recommendations provided in the June 2003 audit and will seek outside legal counsel to assist in formulating policies for the Board. The Board adopted a policy in December, 2004 which permits the hiring of a retired attorney to provide assistance to the Board in the development of policies and other matters. The Board is currently in the process of hiring such a Special Counsel. With respect to the points made in (ii) and (iii) above the Board stated in its response that it will create a manual and include procedures for conducting all levels of appeals and it will establish a policy for having independent counsel and will provide funding accordingly. The Board has adopted an appeals procedure and is currently working on a pamphlet for appellants to explain the appeals process. As mentioned above, the Board is in the process of hiring a Special Counsel. With respect to the point made in (iv) above the Board stated that it will appoint a training coordinator and develop a formalized training plan for the Board. The Board adopted a formal orientation program for new Board members which includes training by a Department training coordinator, an overview of Board member duties and responsibilities and provision of copies of the Military and Veterans Code and the Bagley-Keene Act. With respect to the point made in (v) above, the Department stated that it is addressing this issue through its efforts to effect passage of federal legislation and it is continuing to monitor funding pools to determine if and when an alternative funding source may be necessary. In particular, the Department explained that in order to provide a home loan benefit to the greatest number of qualifying veterans, the Department has been engaged in efforts to change federal tax laws governing QVMB-backed loans. Although the audit pointed out that similar efforts made in 1997 and 1999 were unsuccessful, the Department believes that since the September 11, 2001 tragedy and the recent war in Iraq, the political climate is positive for the passage of bills regarding veterans' issues and that a bill to change the federal tax law introduced in the United States Senate would find sufficient support to become law. In 2005, the Department, along with agencies offering similar programs in four other states, has worked on a new bill to change federal tax laws governing QVMB-backed loans that may be introduced this year. There can be no assurance that any such bill, if introduced, would become law.

THE PROGRAM

General

The Department began making low interest rate farm and home financing available to veterans after World War I, following the enactment by the California Legislature (the "Legislature") of the Veterans Farm and Home Purchase Act of 1921. In 1943, the Legislature enacted the Veterans Farm and Home Purchase Act of 1943 ("1943 Act") which modified the Program to meet new needs of veterans. The 1943 Act was superseded by the Veterans Farm and Home Purchase Act of 1974 ("1974 Act") which again modified the Program. The 1943 Act established the 1943 Fund in the State Treasury, which is the principal fund utilized by the Program.

Since its inception, the Program has assisted over 416,500 veterans to purchase farms and homes throughout the State through long-term housing and farm loans. The sales of revenue bonds (including Revenue Bonds) and Veterans G.O. Bonds, combined with surplus revenues under the Program not needed at any given time to meet the then-current bond retirement schedules and operating costs, have financed the purchase of farms and homes since the Program's inception. As of December 31, 2004, there were 17,643 Contracts of Purchase outstanding with a remaining principal balance of $1,539,224,000. As of December 31, 2004 the Department had approximately 353 pending applications for Contracts of Purchase in the approximate total principal amount of $74,509,000. See EXHIBIT 2 to this APPENDIX B – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Existing Contracts of Purchase" and "– Amounts Expected to be Available to Finance Contracts of Purchase and Related Investments" for information regarding existing Contracts of Purchase and moneys available to finance additional Contracts of Purchase.

The description of the Program under this heading is a description of the Program as it currently exists under the Veterans Code and the Department's implementation thereof. The Veterans Code and the Department's implementation of the Program are subject to change. The Program is also subject to the Federal Tax Code, as noted below.

Qualifying Veteran Status

Veterans Code. A veteran must meet qualifications established under State law in the Veterans Code in order to participate in the Program. The qualifications specified in the Veterans Code are subject to change by the Legislature. The Veterans Code allows the Department to finance Contracts of Purchase for:

(a) veterans who have served, generally, at least ninety days on active duty in the Armed Forces of the United States, unless sooner discharged because of a service-connected disability, and have received an honorable discharge or been released from active duty under honorable conditions during one of the following periods:

(i) April 6, 1917 through November 11, 1918; December 7, 1941 through December 31, 1946; or June 27, 1950 through January 31, 1955 (such veterans are referred to as "Earlier War Veterans");

(ii) February 28, 1961 through August 4, 1964 if the veteran served in the Republic of Vietnam during that period ("Early Vietnam Veterans"); or August 5, 1964 through May 7, 1975 (all veterans referred to in this clause (ii) are "Vietnam Era Veterans"); or

(iii) on or after August 2, 1990, through a date as yet to be determined by the President of the United States; at any time in Somalia, or in direct support of the troops in Somalia, during Operation Restore Hope; or at any time in an expedition or campaign for which a medal was authorized by the United States

Government such as the Armed Forces Expeditionary and Vietnam Service Medals (such veterans are referred to as "Recent War Veterans");

(b) any member of the reserves or National Guard who is called to, and released from, active duty or active service, regardless of the number of days served, during any period when a presidential executive order specifies the United States is engaged in combat or homeland defense, and who received an honorable discharge or was released from active duty or active service under honorable conditions;

(c) any person who qualifies under the Federal Tax Code for financing from Revenue Bonds or unrestricted funds of the Department and who served in the active military, naval, or air service for a period of not less than ninety consecutive days and who received an honorable discharge or was released from active duty under honorable conditions (such veterans are referred to as "Peacetime Veterans"); and

(d) any person who qualifies under the Federal Tax Code for financing from Revenue Bonds or unrestricted funds of the Department and is at the time of application for benefits, a member of the California National Guard or a reserve component of any branch of the United States Armed Forces who has enlisted or been commissioned in that service for a period of not less than six years and has completed a minimum of one year of satisfactory service.

Amendments to the Veterans Code effective January 1, 1998 added Early Vietnam Veterans and Peacetime Veterans and amendments effective January 1, 2005 added those persons described in paragraphs (b) and (d) above as veterans eligible to receive Contracts of Purchase. These amendments, together with various financial and programmatic changes implemented by the Department, have significantly increased the universe of potential eligible veterans. See EXHIBIT 2 to this APPENDIX B – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA."

Federal Tax Code. In order to determine which Department moneys can be used to finance Contracts of Purchase, the Department must also take into account the requirements of Federal law set forth in the Federal Tax Code, which limits the universe of veterans eligible to receive Contracts of Purchase financed from certain sources. See APPENDIX E – "CERTAIN FEDERAL TAX CODE REQUIREMENTS." Applying the current Federal Tax Code separates the Department's lendable moneys into three classes:

(a) "Unrestricted Moneys" (derived from certain moneys in the 1943 Fund, certain proceeds of pre-Ullman (as defined below) Revenue Bonds and Veterans G.O. Bonds, and certain future issues of taxable bonds, if any), which can finance Contracts of Purchase for those veterans who qualify under the applicable provisions of the Veterans Code (the QMB Loan Eligibility Requirements (defined below) do not apply to Contracts of Purchase financed by Unrestricted Moneys). The Department has implemented a policy (which is subject to change) to make Unrestricted Moneys available for Earlier War Veterans, Vietnam Era Veterans, Recent War Veterans and Peacetime Veterans. ("Pre-Ullman" refers to the period prior to enactment of Federal Tax Code programmatic restrictions on the use of proceeds of tax-exempt bonds to finance mortgage loans.);

(b) "Qualified Veterans Mortgage Bond Proceeds" (derived exclusively from proceeds of Veterans G.O. Bonds) which can finance Contracts of Purchase for any veteran who (i) qualifies under the Veterans Code; (ii) served on active duty prior to January 1, 1977; and (iii) was released from active duty fewer than 30 years before receiving such financing. The last date of veteran eligibility under clause (iii) is December 31, 2036 for a veteran with 30 years of continuous service after December 31, 1976. (The QMB Loan Eligibility Requirements (defined below) do not apply to Contracts of Purchase financed by moneys derived exclusively from proceeds of Veterans G.O. Bonds.) These proceeds can finance Contracts of Purchase for Earlier War Veterans and Vietnam Era Veterans; and

(c) "Qualified Mortgage Bond Proceeds" (which are principally derived from Revenue Bond proceeds other than pre-Ullman Revenue Bond proceeds), can finance Contracts of Purchase for any veteran who (i) qualifies under the Veterans Code, and (ii) satisfies certain requirements imposed by the Federal Tax Code principally limiting the family income of applicants and the property purchase price, and, subject to certain exceptions, requiring that the veteran not have had a present ownership interest in his principal residence in the three years prior to obtaining such financing ("QMB Loan Eligibility Requirements").

Allocation of Lendable Moneys

For veterans who qualify for Contracts of Purchase from two or more of the above-described financing sources, the Department may select the source of funds to be used in its sole discretion. The Department's goal is to maximize the availability of Program benefits. Current policy is that all veterans who qualify for Qualified Veterans Mortgage Bond Proceeds are funded from that source and all other eligible veterans are funded from Unrestricted Moneys. Available Qualified Veterans Mortgage Bond Proceeds recycling funds are used for National Guard or Reserves members who are only eligible for those funds under State law.

Administration of the Farm and Home Purchase Program

The Department finances new and existing single-family homes, farms and mobile homes located in the State by acquiring the property selected by a veteran under a Contract of Purchase. The Department also finances home improvements with respect to properties covered by existing Contracts of Purchase, subject to applicable restrictions of the Federal Tax Code. A Contract of Purchase creates an installment land sale contract between the Department and the veteran which is somewhat analogous to a loan from the Department to the veteran. The amount which the Department finances is reflected in the Contract of Purchase as the "purchase price." See "THE PROGRAM – Contracts of Purchase" in this APPENDIX B.

At present under the Veterans Code, the maximum purchase price to the Department of an existing home or the sum to be expended by the Department pursuant to a Contract of Purchase for a home to be constructed shall not exceed the current maximum Fannie Mae loan limit for a single-family home that is annually set by Fannie Mae ($359,650 as of January 1, 2005) and for farms is 150% of such Fannie Mae limit (except that the limitation with respect to mobile homes located on or to be located on a leased or rented site in a mobile home park is

$125,000 and except that the maximum purchase price for any home may be increased by an additional $5,000 for certain purposes). The Legislature has periodically made changes in the maximum amount that may be financed under a Contract of Purchase. The Federal Tax Code imposes maximum purchase prices on properties which are the subject of Contracts of Purchase financed by Qualified Mortgage Bond Proceeds. The Federal Tax Code permits such maximums to be adjusted periodically. (No Federal Tax Code purchase price limits apply to Contracts of Purchase financed from Unrestricted Moneys or Qualified Veterans Mortgage Bond Proceeds.) These Federal Tax Code requirements vary depending upon where the property is located, if it is in a targeted or non-targeted area, and whether it is a new or existing home. The maximum purchase price under the Program is, therefore, the Veterans Code maximum amount or, if the Contract of Purchase is being financed by Qualified Mortgage Bond Proceeds, the lesser of the Veterans Code maximum amount or the maximum amount under applicable provisions of the Federal Tax Code.

Although the Veterans Code does not impose maximum income limits, the Federal Tax Code imposes maximum income limits applicable only to veterans obtaining Contracts of Purchase financed by Qualified Mortgage Bond Proceeds. The income limits vary by statistical area and family size. No maximum income limits apply to veterans obtaining Contracts of Purchase financed by Unrestricted Moneys or Qualified Veterans Mortgage Bond Proceeds.

Any veteran who qualifies under the Veterans Code and the Federal Tax Code may be granted a subsequent Contract of Purchase so long as any previous Contract of Purchase has been paid in full or the veteran lost his interest in the previous Contract of Purchase through divorce or dissolution of marriage.

Contracts of Purchase

General. Pursuant to the Program, the Department and the veteran enter into a Contract of Purchase for a farm, home or mobile home. Under a Contract of Purchase, the veteran has the benefits of ownership as the equitable owner, but title to the property and improvements is held by the Department as the legal owner until the final principal payment is made. Property sold under a Contract of Purchase may not be transferred, assigned, encumbered, leased, let or sublet without the written consent of the Department. Any permitted encumbrance must be junior or secondary to the Department's interest in the property.

Before 1998, Contracts of Purchase were not insured or guaranteed by the Federal Housing Administration, the United States Department of Veterans Affairs (the "USDVA"), Rural Development (formerly, Farmers' Home Administration), or any private primary mortgage insurer. In 1998, the Department was approved by the USDVA as an originator of loans eligible to receive a guaranty from the USDVA. In addition to the USDVA guaranty, the Department has secured primary mortgage insurance for certain prior and future Contracts of Purchase not guaranteed by the USDVA with loan-to-value ratios ("LTV") above 80% from Radian Guaranty Inc. ("Radian"). See "THE PROGRAM – Loan Insurance – Primary Mortgage Insurance." Certain Contracts of Purchase are not the subject of loan insurance or guarantees. See EXHIBIT 2 to this APPENDIX B – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Existing Contracts of Purchase."

The terms of the Contracts of Purchase are substantially identical, except for interest rates on Contracts of Purchase originated after January 1, 1999, regardless of whether they are funded by Unrestricted Moneys, Qualified Veterans Mortgage Bond Proceeds or Qualified Mortgage Bond Proceeds, except for Federal Tax Code-mandated differences in Contracts of Purchase financed with Qualified Mortgage Bond Proceeds. Two ways in which such Contracts of Purchase are different are: (a) Contracts of Purchase financed by Qualified Mortgage Bond Proceeds have more restrictions on the right of a purchaser to assume the obligations under the Contract of Purchase than do Contracts of Purchase financed by Unrestricted Moneys or Qualified Veterans Mortgage Bond Proceeds and (b) certain Contracts of Purchase financed by Qualified Mortgage Bond Proceeds are subject to Federal Tax Code-mandated recapture provisions. In addition, the Federal Tax Code contains the QMB Loan Eligibility Requirements, which are numerous loan eligibility restrictions on borrowers receiving financing from proceeds such as Qualified Mortgage Bond Proceeds. These restrictions require, among other things, and subject to certain exceptions contained in the Federal Tax Code, that borrowers (i) not have had a present ownership interest in their principal residence during the three-year period preceding the date of financing, (ii) are eligible to finance the purchase of residences with purchase prices not in excess of limits stated in the Federal Tax Code, (iii) must not have family incomes in excess of limits stated in the Federal Tax Code, (iv) may not use the proceeds of the financing to refinance an existing mortgage loan and (v) may use the proceeds of the financing only to finance one-family or one-to-four family dwelling units meeting certain criteria. The Federal Tax Code includes certain procedures that an issuer of Qualified Mortgage Bonds may undertake to satisfy these requirements, but requires that 95% or more of the proceeds of the bond issue be used in full compliance with the loan eligibility restrictions.

Since the number and aggregate principal balance of Contracts of Purchase relating to farms and mobile homes, and Contracts of Purchase financed pursuant to the 1943 Act, are statistically insignificant, the discussion below is limited to Contracts of Purchase financed under the 1974 Act for homes, excluding farms and mobile homes in rental parks, unless otherwise indicated. See EXHIBIT 2 to this APPENDIX B – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Existing Contracts of Purchase."

Many factors affect the ability or willingness of homebuyers to make mortgage loan payments and of potential homebuyers to borrow money to purchase homes. These factors include, among others, general economic conditions, interest rates, and costs of living.

Origination. The Veterans Code, in certain cases, requires the veteran to make an initial payment of at least 2% of either the purchase price or the market value of the property, whichever is less. See "— Recent Legislative Changes to the Program" below. In the case of veterans who are ineligible for a full USDVA guaranty, Department policy requires the veteran to make an initial payment of 3% of either the purchase price or the market value of the property, whichever is less. The balance of the purchase price, including USDVA guaranty fees, may be amortized over a period fixed by the Department, not exceeding 30 years and 32 days for all Contracts of Purchase guaranteed by USDVA, and 40 years for any other Contracts of Purchase. Pursuant to its policy, the Department issues all new Contracts of Purchase, except for Contracts of Purchase for mobile homes, for terms of 30 years unless a shorter term is requested. Existing contracts are occasionally extended beyond 30 years in cases of extreme financial hardship.

In addition to the initial payment, if any, referred to in the prior paragraph, a Loan Origination Fee ("LOF") of 1% of the loan amount is collected at close of escrow on all contracts issued after January 1, 1999. This fee must be paid in escrow by the buyer or seller. If the loan application is submitted through an approved mortgage broker, the 1% fee is paid directly to the mortgage broker through the escrow. Otherwise, the fee is retained by the Department. Contracts of Purchase are originated by the Department's field offices and mortgage brokers. After a preliminary screening in the field offices, applications will be forwarded to a centralized underwriting unit in Sacramento for processing. The field offices handle overflow loan processing from Sacramento and handle all processing for home improvement loans and construction loans. The mortgage brokers deal directly with the office that is processing the loan. An appraisal fee of $350 to $450 is collected by the Department from the applicant and is paid directly to the appraiser by the Department upon completion of the assignment. In rare cases, where the appraisal is performed by a Department employee, the fee is retained by the Department.

Home Improvement Loans. The Veterans Code permits the Department to finance permanent home and property improvements. Under the current home improvement loan program, when a home improvement loan is approved, total financing, including the balance of the original loan, the amount of the improvement loan, and any other encumbrances, cannot exceed 90% of the improved market value of the property. Typically this total LTV is much lower than 90%. Except in the case of hardship, improvement loans are not approved for veterans who have had significant delinquencies in the 12 months immediately preceding the application. Funds are either disbursed by the Department directly to the contractors (or vendors) as the improvements are completed or veterans, who are licensed contractors, can be reimbursed for construction costs. For a home improvement loan subordinate to an existing Contract of Purchase, a separate Contract of Purchase covering only the improvements is executed, bearing interest at the same rate as the veteran's existing Contract of Purchase on home improvement loans made prior to January 1, 2005, or at current Department rates on home improvement loans made after January 1, 2005. The new Contract of Purchase is payable over a term up to 15 years based on the amount of the Contract of Purchase. In no event can the term, from the inception of the original Contract of Purchase through the pay-off of the improvement Contract of Purchase, exceed 40 years. A LOF of 1.5% of the improvement Contract of Purchase amount is charged. The maximum home improvement loan for veterans funded with Qualified Mortgage Bond Proceeds is $15,000 over the term of the original Contract of Purchase. Home improvement loans funded with Unrestricted Moneys or Qualified Veterans Mortgage Bond Proceeds are available up to a maximum of $50,000. Subsequent home improvement Contracts of Purchase may be granted, if funds are available, so long as there is only one home improvement Contract of Purchase to any veteran outstanding at any time. Currently, less than one percent of the total principal balance of all Contracts of Purchase is derived from home improvement loans.

Contracts of Purchase for the purchase of a building site and construction of a home are available. Qualifying sites include undeveloped sites/acreage, lots in subdivision developments, and sites in non-profit self help developments. Mobile homes in parks do not qualify. Construction of the improvements must be performed by a licensed California contractor. The Department does not submit Contracts of Purchase which finance home construction for USDVA guaranty.

The Department also limits availability of financing to veterans on the basis of their personal credit status. Where applicable, the Department's current lending criteria conform to those of the USDVA for participation in the USDVA guaranty program. Department procedures are consistent with those established by USDVA for its loan guaranty program. The Department uses a standard set of underwriting criteria for all of its loans, which conforms with USDVA underwriting criteria.

Recent Legislative Changes to the Program. Effective January 1, 2004, the Veterans Code permits veterans eligible for a full USDVA guaranty, subject to the Department's underwriting criteria, to qualify for a loan requiring no down payment. Effective January 1, 2004 the Veterans Code permits the Department to finance permanent home and property improvements for veterans with no existing financing or subordinate to existing financing (provided by lenders other than the Department) through the use of a deed of trust as the financing instrument. The Department has not yet implemented a program to fund loans subordinate to existing debt.

The history of the Department's originations of Contracts of Purchase is set forth in EXHIBIT 2 to this APPENDIX B – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Contracts of Purchase Origination and Principal Repayment Experience."

Servicing. All Contracts of Purchase are serviced by the Department. Late penalty charges are applied to Contracts of Purchase that have a remaining amount due of $25 or more at the close of any account month. A $10 late penalty charge is imposed on Contracts of Purchase originated before October 1984. Contracts of Purchase originated during and after October 1984 are subject to a late penalty charge of 4% of the principal and interest portion of the installment, consistent with penalties authorized by USDVA.

The Department may, in any individual case and for good cause, permit the postponement from time to time, and upon such terms as it deems proper, of the payment of the whole or any part of any installment. Contracts of Purchase may also have terms in excess of 30 years if home improvement loans have been obtained, as discussed above, or under certain hardship conditions. The terms of Contracts of Purchase guaranteed by USDVA, however, cannot exceed 30 years and 32 days, unless the USDVA, in its sole discretion, approves such extension.

Prepayment Penalties. There are no prepayment penalties on any Contracts of Purchase. The Department's actual past prepayment experience for existing Contracts of Purchase is set forth in EXHIBIT 2 to this APPENDIX B – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Contracts of Purchase Origination and Principal Repayment Experience."

Cancellations and Delinquencies. The Department's policies regarding delinquencies and cancellations conform to USDVA loan guaranty program requirements and the requirements of Radian. In the event of a failure to comply with any of the terms of a Contract of Purchase, the Department may cancel the Contract of Purchase and be released from all obligations, at law or in equity, to convey the property. In such event, the veteran's rights under the Contract of

Purchase may be forfeited and all payments made by the veteran prior to termination of the Contract of Purchase deemed to be rental paid for occupancy. Upon such forfeiture, the Department takes possession of the property covered by the Contract of Purchase and resells it.

If a veteran does not make a payment by the 16th day of the month in which the payment is due, the payment is considered "delinquent." The mortgage finance system (Mitas) generates a reminder letter automatically if payment is not received by the 20th day of the month, which advises the veteran that the account is delinquent. If payment is not received by the 30th day of the month, a second reminder letter is issued. If the account remains delinquent 60 days, a Notice of Intent to Cancel Contract ("NICC") is issued giving notice that the Contract of Purchase may be canceled at the end of the 30-day notice period unless the account is brought current. Department personnel then initiate telephone contact with veterans with delinquent accounts. If the veteran has not paid by the 70th day of the delinquency, a letter is issued reminding the veteran that he or she must bring the account current within 30 days of the NICC date. A schedule for liquidation of delinquent payments satisfactory to the Department is arranged during this period; however, if the account remains delinquent after such 30-day period and no schedule for liquidation of delinquent payments has been agreed upon, the Department may begin cancellation of the Contract of Purchase. If a schedule of liquidation has been agreed to with respect to a Contract of Purchase and the veteran makes all regularly scheduled payments and liquidation payments on a timely basis, the Department does not begin cancellation of the Contract of Purchase.

The Department's headquarters Collections Unit monitors the delinquency throughout this process, orders a title search to identify any junior lienholders and forwards the pertinent information to the Department's Foreclosure and REO Unit for further precancellation processing in accordance with the California Code of Regulations, Title 12, Section 344, Military and Veterans Affairs. Junior lienholders are identified and sent notices giving them 30 days (40 days in the case of Federal tax liens) to protect their interest by beginning foreclosure proceedings. If the account is not brought current during such notice period to junior lienholders and no junior lienholder proceeds with a foreclosure action to protect its interest, the Department's Foreclosure Unit cancels the contract, and a Notice of Cancellation is mailed to the veteran and recorded. The Department's Foreclosure Unit then takes steps to evict occupants and clear any remaining liens. If judicial action is required, the case is referred to the Department's Law Division for additional processing.

After all remaining liens are removed and the property is vacant, the repossessed property is repaired and improved, if necessary and feasible, and is marketed through the Department's centralized repossession sales unit (Foreclosure and REO Unit) through a Pre-Advertising Listing ("PAL") program. The PAL program involves listing a property for sale with a licensed real estate broker or agent, at an overall commission rate which typically does not exceed 6%. The Department is required to advertise and accept sealed offers during a 2-week period, and the property is sold to the highest acceptable bidder (best net return). If no acceptable bids are received, the property will continue to be marketed by the listing real estate agent until an acceptable offer is received and the property is sold.

Federal law provides certain protections to military personnel on active duty or reservists ordered to report for military service under The Soldiers' and Sailors' Civil Relief Act of 1940, as amended (the "Soldier's and Sailor's Relief Act"). Under the Soldier's and Sailor's Relief Act, the veteran may seek a stay (or a court may on its own motion grant a stay) of any court action or proceeding. The Department conducted a voluntary survey by mail in 2003 of all holders of Contracts of Purchase. Approximately 375 holders of Contracts of Purchase indicated that they were members of the National Guard or the Reserves subject to being called to active duty. To date, there has been no material impact on the 1943 Fund.

See EXHIBIT 2 to this APPENDIX B – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – CONTRACTS OF PURCHASE – Cancellations and Delinquencies" for additional information regarding the status of Contracts of Purchase.

Interest Rates. Contracts of Purchase originated prior to January 1, 1999 bear interest at a rate which is set by the Department and may be changed with the approval of the Board and the Veterans' Finance Committee of 1943 (the "Finance Committee"). Most Contracts of Purchase originated prior to January 1, 1999 currently bear interest at a rate of 6.95%. The Veterans Code currently requires that, generally, all Contracts of Purchase originated prior to January 1, 1999 (the "pre-1999 Contracts of Purchase") bear the same interest rate. In accordance with the current provisions of the Veterans Code, the interest rate for such pre-1999 Contracts of Purchase can be changed annually as deemed necessary. The effective date of a higher rate of interest on pre-1999 Contracts of Purchase may occur only once in any calendar year unless a finding is made by the Board and the Finance Committee that such additional action is necessary to protect the solvency of the 1943 Fund.

Legislation passed in 1998 (i) eliminated the uniform interest rate requirement for Contracts of Purchase originated on or after January 1, 1999; (ii) allows the Department to establish non-uniform fixed or variable interest rates for such Contracts of Purchase; and (iii) allows the Department to modify such interest rates, or the methodology and timing for determining or modifying interest rates, from time to time, subject to the approval of the Board and the Finance Committee. The Department received approval to implement a flexible mechanism to provide for periodic adjustments of the interest rate on new Contracts of Purchase funded from Qualified Mortgage Bond Proceeds, Qualified Veterans Mortgage Bond Proceeds, and Unrestricted Moneys. As a result of such mechanism, interest rates for new Contracts of Purchase funded on and after April 4, 2005 are currently 5.50% for Contracts of Purchase financed using Qualified Mortgage Bond Proceeds, 5.15% for Contracts of Purchase financed using Qualified Veterans Mortgage Bond Proceeds, and 5.50% for Contracts of Purchase using Unrestricted Moneys. Interest rates on Contracts of Purchase are expected to be established in the future based on various factors deemed appropriate by the Department, subject in all cases to the requirements of the resolution authorizing the issuance of Revenue Bonds (the "Revenue Bond Resolution") for the filing of Cash Flow Statements and conformance with Program Operating Procedures. As noted herein, the Program Operating Procedures are operating policies of the Department governing the discretionary activities of the Department under the Revenue Bond Resolution. The Cash Flow Statement consists of the conclusion by an authorized representative of the Department that projected revenues will be sufficient to provide for timely payment of principal of and interest on the Revenue Bonds and expenses, under each scenario included in the quantitative analysis which accompanies the Cash Flow Statement. See EXHIBIT 2 to this APPENDIX B – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Selected Principal

Flows with respect to Contracts of Purchase funded by both Veterans G.O. Bonds and Revenue Bonds."

The Soldiers' and Sailors' Relief Act provides that if a veteran obtained a Contract of Purchase and is later recalled to active duty, then during the period of military service the interest rate on the Contract of Purchase cannot exceed 6% (unless the ability of the veteran to pay interest in excess of 6% is not materially impaired by such military service). Accordingly, the effect of any application of The Soldiers' and Sailors' Relief Act in most cases would be a reduction in the applicable interest rate of less than one percent or no reduction at all.

Loan Insurance

Since 1997, the Department has completed several programmatic changes, including obtaining loan insurance from a private primary mortgage insurer for certain existing Contracts of Purchase with high LTVs, and USDVA guarantees or private primary mortgage insurance for all new Contracts of Purchase (except mobile homes in parks, construction loans during the construction period, and home improvement loans) with LTVs above 80% up to 100%. In addition to the LOF and initial payment, the Department collects a funding fee of from 1.25% up to 3.3% of the Contract of Purchase amount, based on the LTV for each Contract of Purchase which exceeds an LTV of 80%. For USDVA guaranteed loans, the funding fee may be added to the purchase price. On Radian guaranteed loans, the maximum loan amount is 97% so the funding fee cannot be added to the loan unless the downpayment is increased so that the total loan amount, including the funding fee, does not exceed 97%. Veterans described above who are ineligible for a full USDVA guaranty and therefore are obligated to make an initial 3% payment must advance a funding fee of up to 2% of the base loan amount to the Department at close of escrow, and the funding fee may not be added to the base loan amount. With respect to eligible Contracts of Purchase, this fee is paid to the USDVA for the cost of the loan guaranty. If the veteran or the property is not eligible for a USDVA loan guaranty, the funding fee is retained by the Department, and a portion of such funding fees is used by the Department to pay costs related to the Radian primary mortgage insurance. Any change to the foregoing insurance and guaranty expectations could require an amendment to the Department's Program Operating Procedures and delivery of a new Cash Flow Statement. A significant principal amount of Contracts of Purchase are not covered by loan insurance. See EXHIBIT 2 to this APPENDIX B - "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA - Contracts of Purchase - Existing Contracts of Purchase - Current Loan-to-Value Ratio of Contracts of Purchase."

Primary Mortgage Insurance. The Department purchased from Radian a policy of primary mortgage insurance for a pool of certain prior Contracts of Purchase with LTVs above 80%. The insurance financial strength of Radian is rated "AA" by S&P, "Aa3" by Moody's and "AA" by Fitch. Such ratings reflect only the view of the respective rating agencies and an explanation of the significance of such ratings may be obtained from the respective rating agencies. There is no assurance that the ratings will continue for any given period of time or that they will not be revised or withdrawn entirely by such ratings agencies if, in their judgment, circumstances so warrant. This Radian policy provides coverage on such pool back to February 1, 1998. The Department has purchased an additional policy of primary mortgage insurance from Radian which provides the same coverage as provided in the original policy, except that the

Department now includes certain existing and all new Contracts of Purchase with 97% to 100% LTV ratios that are not qualified for USDVA guarantees (except mobile homes in parks, construction loans and home improvement loans, all of which continue to be covered by the Department). Under this second policy, Radian has committed to insure Contracts of Purchase originated by the Department after January 1, 2000 until the aggregate principal amount of Contracts of Purchase insured under the second policy reaches $1.6 billion. Each of the Radian policies provides for coverage for aggregate losses incurred on Contracts of Purchase following property disposition, above an aggregate 2% deductible based upon a percentage of the originally insured balances of the Contracts of Purchase of the applicable pool. Under both Radian policies, once the applicable aggregate deductible has been reached, insurance claims may be made based upon the individual LTV of the particular defaulted Contract of Purchase, as set forth below. For these purposes, LTV is calculated using the original appraised value of the property.

Radian Mortgage Insurance Coverage Ratios Subject to a Deductible of 2% of the Originally Insured Balances of the Contracts of Purchase in the Applicable Insured Pool

LTV Category	% of Coverage
97.01% to 100.00%	35%
95.01% to 97.00%	35%
90.01% to 95.00%	30%
85.01% to 90.00%	25%
80.01% to 85.00%	17%

For information regarding the principal amount of Contracts of Purchase covered by the Radian policies, see EXHIBIT 2 to this APPENDIX B – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Existing Contracts of Purchase - Current Loan-to-Value Ratio of Contracts of Purchase."

USDVA Guaranty Program. The Department was approved by the USDVA as a "supervised lender with automatic processing authority" as of March 10, 1998. On July 27, 1998, the Department received USDVA approval under the Lender Appraisal Processing Program ("LAPP") to process appraisals and determine reasonable value without prior USDVA review. The Department seeks USDVA loan guarantees for all Contracts of Purchase with a LTV of 80% or higher, unless the Contract of Purchase is not eligible for USDVA guaranty. Contracts of Purchase not eligible for guaranty are primarily contracts with veterans who have previously used their USDVA guaranty eligibility and do not qualify for reinstatement, contracts for the purchase of new homes not inspected by USDVA during construction and contracts where the purchase price exceeds USDVA limits. Also, a very small number of veterans have service that meets Veterans Code eligibility requirements but does not meet USDVA eligibility requirements.

The Servicemen's Readjustment Act of 1944, as amended, permits a veteran (or in certain instances the veteran's spouse) to obtain a mortgage loan guaranty from USDVA covering mortgage financing of the purchase or construction of a one-to-four family dwelling unit at interest rates permitted by USDVA. The USDVA program has no preset mortgage loan limits and permits the guaranty of mortgage loans of up to 30 years and 32 days' duration unless the USDVA, in its sole discretion, approves an extension. Under the USDVA program, the maximum USDVA guaranty on a loan is an amount equal to 25% of the Freddie Mac conforming loan limit for a single family residence. The 2005 Freddie Mac conforming loan limit for a single family residence for 2005 is $359,650. The liability on the guaranty is reduced or increased *pro rata* with any reduction or increase in the amount of indebtedness, but in no event will the amount payable on the guaranty exceed the amount of the original guaranty. Notwithstanding the dollar and per centum limitations of the guaranty, a mortgage holder will ordinarily suffer a monetary loss only where the difference between the unsatisfied indebtedness and the proceeds of a foreclosure sale of a mortgaged property is greater than the original guaranty as adjusted. Periods without interest payments prior to foreclosure will also increase the potential for losses. In the event of a default in the payment of a USDVA loan, but prior to a suit or foreclosure, USDVA may, at its option, pay to a mortgage holder the unpaid balance of the obligation plus accrued interest and receive an assignment of the loan and security. For information regarding the amount of Contracts of Purchase guaranteed by the USDVA, see EXHIBIT 2 to this APPENDIX B – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Existing Contracts of Purchase - Current Loan-to-Value Ratio of Contracts of Purchase."

Property and Life and Disability Insurance

The Veterans Code and/or long-standing Department policy have called for the veteran contract-holder to maintain certain insurance with respect to the property covered by a Contract of Purchase. Insurance must be in the amount and under the conditions specified by the Department, and is either provided by the Department or by insurance companies selected by the Department. Any change to the insurance requirements could require amending the Department's Program Operating Procedures.

Fire and Hazard Coverage. The Department self-insures for fire and hazard losses, using the 1943 Fund to make payments to veterans, up to a Department deductible. The Master Policy described below (the "Master Policy") provides $50,000,000 coverage in excess of the Department deductible, except that the Master Policy does not cover mobile homes, condominiums or planned unit development properties covered by blanket insurance policies provided by homeowners' associations. The Department contracted with Marsh Risk and Insurance Services to conduct a Conflagration Exposure Analysis. The analysis concluded that the probable maximum exposure risk to the properties insured under the Program from a major event, or conflagration, would not exceed $20,000,000, which is the first layer of coverage of the Master Policy, in excess of the Department's $2,500,000 per occurrence and $13,000,000 annual aggregate deductibles. Therefore, the total coverage in excess of the Department deductible was reduced from $100,000,000 to $50,000,000 for the policy year beginning October 31, 2003. The Master Policy is provided by commercial insurers (the "Provider"). The lead insurer for the Provider is Allianz Global Risks U.S. Insurance Company.

Under each Contract of Purchase, the veteran is required to pay the sum charged to his or her account to cover costs of providing the insurance coverage including the insurance premium due under the Master Policy with respect to his or her property. From the amount charged to each veteran, the Department retains a portion to provide the sums necessary to pay all losses up to the Department deductible, which is $2,500,000 per occurrence or $13,000,000 per policy year. If the total losses from a single occurrence exceed $2,500,000 or if the aggregate of all fire and hazard insurance losses for a policy year exceed $13,000,000, liability for the excess will be covered under the Master Policy. The coverage under the Master Policy extends to October 31, 2005. The Master Policy is an all-physical loss form.

Fire and hazard insurance coverage for participants in the Program is adjusted annually to reflect increasing building costs and is maintained on a guaranteed replacement cost basis for homes and on an actual cash value basis for outbuildings. A $250 deductible payable by the veteran applies to each loss. Claims must be submitted within 12 months of loss. Each veteran with a Contract of Purchase pays an annual insurance premium equal to $0.22 per $100 of insured value which is prorated and included in the veteran's monthly installment. Claims adjustments and payments are made on behalf of the Department and the provider of the Master Policy by an affiliate of such provider.

The Department anticipates that the dollar amount of claims resulting from the major wildfires in Southern California in October and November 2003, combined with other claims, will not exceed the $13,000,000 annual aggregate deductible under the Master Policy. This is consistent with the results of the Conflagration Exposure Analysis.

Disaster Indemnity Plan. The Department provides certain disaster indemnity and catastrophe real property insurance ("Disaster Indemnity Plan"). Neither such insurance nor the indemnity fund described below are payable from or a part of the 1943 Fund. The Disaster Indemnity Plan indemnifies participants against the cost of repairing damage in excess of a deductible caused by flood or earthquake. The deductible for flood losses is $500 and the deductible for earthquake losses is $500 or 5% of the amount of loss, whichever is higher. The catastrophe insurance has been obtained from a consortium of ten insurance companies for a total of $50,000,000 of coverage with a $4,000,000 deductible per occurrence and in the aggregate annually. Once such deductible has been exceeded, subsequent occurrences are subject to a $100,000 per occurrence deductible. The 2004 – 2005 one-year premium for this coverage is $3,582,500.

Each veteran in the Program participates in the Disaster Indemnity Plan and pays his or her *pro rata* share of the annual premium. Such payments are deposited in an indemnity fund created in the Treasury of the State to be utilized to pay the deductible discussed above. Each veteran pays an initial assessment of $.80 per $1,000 of insured value, and any assessments as may be required to sustain the indemnity fund. The value of the indemnity fund as of June 30, 2004 was $14,879,000.

Effective December 1, 1997, the Department purchases individual flood policies through the Federal Emergency Management Agency ("FEMA") covering all properties financed by Contracts of Purchase that are located in designated flood zones. Coverage under this policy is renewable annually.

Life and Disability Coverage. In the past, the Department self-insured from the 1943 Fund life and disability coverage for veterans with Contracts of Purchase. Following a period of significant and recurring losses incurred by the 1943 Fund, the Department, effective

June 1, 1996, replaced most of the Department's self-insured life and disability insurance program with an interim life and disability insurance plan (the "Life and Disability Plan") provided by Pacific Life and Annuity Company ("Pacific Life") (previously PM Group Life Insurance Company). Effective February 1, 1998, after a competitive bidding process, the interim plan was replaced with a long-term life insurance and disability plan, also provided by Pacific Life. Effective February 1, 2003, after another competitive bidding process, the Pacific Life plan was replaced by a three-to-five-year life insurance and disability plan, provided by the Standard Insurance Company. The Department continues to self-insure those veterans who were already receiving disability benefits at the time the Life and Disability Plan was implemented, with benefits equal to the amount of the monthly Contract of Purchase payment at the time of their disability. Those benefits will continue under the provisions of the self-insured plan until the beneficiary returns to active employment or dies, or his or her contract is paid off. Loss reserves for these obligations are actuarially based. The Department holds funds in the 1943 Fund to pay all benefits under the self-insured plan. See "THE 1943 FUND – SELECTED FINANCIAL DATA OF THE 1943 FUND AND DEPARTMENT'S DISCUSSION" in this APPENDIX B.

As noted above, effective February 1, 2003, the Department implemented a new life and disability protection plan, which is provided by the Standard Insurance Company. All holders of Contracts of Purchase who had life and disability coverage (exclusive of those receiving self insured benefits described above) under the prior plan were transferred automatically to the new plan. Major elements of the life and disability coverage, include, for life insurance a five-year principal and interest benefit under the mandatory life coverage. Disability coverage has a 90-day waiting period with a maximum 24-month benefit, unless the injury was the cause of an accident, which would allow for a maximum 60-month benefit. These benefits continue to age 62 for disability and age 70 for life benefit. The goal of the Department in going to bid for a new insurance provider was to improve disability benefits while maintaining the financial integrity of the Program. The new plan reduced the administrative charges for both the insured and self-insured programs, and increased disability benefits, with no increase in premiums.

The new insured life insurance program offers the same five-year rate guarantee on an insurance rated policy. The new insured disability program has three benefit options. Option 1 has a 90-day waiting period, two-year sickness or five-year accident benefit and five years after termination of the two-year sickness or five-year accident benefit, the claimant can qualify for the life of loan benefit if they are unable to perform two so-called Activities of Daily Living, at no additional cost to the claimant. Option 2 also has a 90-day waiting period, but with a premium that is 1.7 times higher than standard and the claimant will receive life of the loan coverage. Option 3 has a one-year waiting period, with life of the loan coverage at no additional premium.

THE 1943 FUND

General

The components of the 1943 Fund are (i) proceeds derived from the sale of Revenue Bonds, (ii) proceeds from the sale of Veterans G.O. Bonds, (iii) amounts receivable under all Contracts of Purchase and from sales of properties subject to cancelled Contracts of Purchase,

(iv) temporary investments, cash and funds and (v) certain other miscellaneous assets. Proceeds of Veterans G.O. Bonds may not be applied to payment of principal of, and interest or any redemption premium on, the Revenue Bonds. The holders of Revenue Bonds are not entitled to compel the sale of Contracts of Purchase and the properties to which they relate, but are entitled to receive payment out of the Revenues derived from those Contracts of Purchase and properties, subject to the prior claims, if any, of the Veterans G.O. Bonds and of the State for reimbursement of debt service payments made on Veterans G.O. Bonds.

In addition to financing Contracts of Purchase and paying or reimbursing debt service on the Veterans G.O. Bonds and Revenue Bonds, as described below, moneys in the 1943 Fund are used to pay administrative costs of the Department, and to fund certain losses from and reserves for property insurance and life and disability insurance described in "THE PROGRAM – Property and Life and Disability Insurance."

For financial information concerning the 1943 Fund, see EXHIBIT 1 to this APPENDIX B – "FINANCIAL STATEMENTS OF THE 1943 FUND FOR FISCAL YEARS 2004 AND 2003 AND INDEPENDENT AUDITOR'S REPORT" and EXHIBIT 3 – "UNAUDITED FINANCIAL STATEMENTS OF THE 1943 FUND FOR THE PERIOD ENDED DECEMBER 31, 2004"

The Act and the Veterans Code provide that the undivided interest created by Resolution RB-1 in favor of the holders of Revenue Bonds in the assets of the 1943 Fund is secondary and subordinate to the interest of the people of the State and the holders of Veterans G.O. Bonds. The 2000 Bond Act provides that on the dates when funds in the General Fund are remitted to bondowners for the payment of debt service on Veterans G.O. Bonds issued under the 2000 Bond Act, moneys shall be returned to the General Fund from the 1943 Fund in an amount equal to such debt service payment (to the extent sufficient moneys are available in the 1943 Fund). Moneys in the 1943 Fund must be paid, on the debt service payment dates of Veterans G.O. Bonds (other than those issued under the Veterans Bond Act of 2000), to the General Fund in the amount of the principal of (whether at maturity or upon redemption or acceleration), and premium and interest on Veterans G.O. Bonds then due and payable (other than debt service payable from the proceeds of refunding bonds). Debt service on Veterans G.O. Bonds is payable from the General Fund, even if the amount transferred from the 1943 Fund to the General Fund is less than such debt service amount. The balance remaining unpaid to the General Fund from the 1943 Fund must be transferred to the General Fund out of the 1943 Fund as soon thereafter as it becomes available, together with interest thereon at the rate borne by the applicable Veterans G.O. Bonds, compounded semiannually. Until such amounts are repaid to the General Fund, no payments may be made on the Revenue Bonds other than from amounts then in the Bond Reserve Account and the Loan Loss Account. These rights with respect to the 1943 Fund do not grant any lien on the 1943 Fund or the moneys therein to the holders of any Veterans G.O. Bonds.

As of December 31, 2004, there were outstanding $1,270,685,000 aggregate principal amount of Veterans G.O. Bonds. Currently, $605,585,000 of new issue Veterans G.O. Bonds are authorized but not issued (not including the Offered Veterans G.O. Bonds). As of December 31, 2004, there were outstanding $575,845,000 aggregate principal amount of Revenue Bonds outstanding, not including the Offered Revenue Bonds. Under the Act, Revenue Bonds in an aggregate principal amount not to exceed $1,500,000,000, at any given time, may be outstanding. The Legislature may increase the amount of Revenue Bonds issuable under the Act or may decrease such amount to an amount not less than the amount of Revenue Bonds then outstanding. Additional information about outstanding Veterans G.O. Bonds and Revenue Bonds is in Exhibit 2 to this APPENDIX B – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Veterans G.O. Bonds and Revenue Bonds."

For additional information regarding the existing interest rates of, and setting interest rates on, Contracts of Purchase, see "THE PROGRAM – Contracts of Purchase" and EXHIBIT 2 to this APPENDIX B – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase."

Selected Financial Data of the 1943 Fund and Department's Discussion

Selected Financial Data of the 1943 Fund

The following table (the "Selected Financial Data") contains selected financial data of the 1943 Fund for fiscal years ended June 30, 2004 and 2003 which has been derived from the financial statements of the 1943 Fund audited by Deloitte & Touche LLP, independent auditors, whose report thereon appears in EXHIBIT 1 to this APPENDIX B, and the Department's accounting records. The Selected Financial Data also contains the comparable financial data of the 1943 Fund for fiscal years ended June 30, 2002, 2001 and 2000, which has been derived from the audited financial statements of the 1943 Fund that are not included herein, and the Department's accounting records for those years. In addition, the Selected Financial Data contains the comparable financial data of the 1943 Fund for the six month periods ended December 31, 2004 and December 31, 2003, which has been derived from the un-audited financial statements of the 1943 Fund that appear in EXHIBIT 2 to this APPENDIX B, and the Department's accounting records for those periods. **This selected financial data should be read in conjunction with the financial statements and notes thereto of the 1943 Fund contained in said EXHIBIT 1 and EXHIBIT 2 and the Department's Discussion of Financial Data contained herein.**

SELECTED FINANCIAL DATA OF THE 1943 FUND
(Dollars in Thousands)

	6 Months Ending Dec. 31, 2004 ***	6 Months Ending Dec. 31, 2003 ***	For Fiscal Years Ending on June 30, 2004	June 30, 2003	June 30, 2002	June 30, 2001	June 30, 2000
ASSETS AND LIABILITIES RELATED TO LENDING AND FINANCING ACTIVITIES:							
CASH AND INVESTMENTS							
Cash and amounts on Deposit in SMIF*	$380,570	$829,375	$589,654	$728,511	$515,052	$324,158	$226,076
Guaranteed Investment Contracts	157,136	285,593	154,890	265,595	363,685	319,476	562,380
Treasury Securities	0	0	0	0	0	0	112,107
Total	537,706	1,114,968	744,544	994,106	878,737	643,634	900,563
DUE FROM VETERANS DEBENTURE REVENUE FUND	37,568	39,068	37,532	37,411	37,346	40,905	33,847
OTHER CURRENT ASSETS	10,790	12,980	10,504	14,517	20,620	30,333	30,903
NET OTHER NON-CURRENT ASSETS	4,601	4,042	10,160	4,751	6,120	33,329	33,255
CONTRACTS OF PURCHASE							
Performing Contracts	1,536,398	1,571,084	1,536,490	1,766,419	2,356,055	2,605,059	2,418,292
Non Performing Contracts	2,826	5,389	2,987	6,248	9,543	18,182	16,764
Total	1,539,224	1,576,473	1,539,477	1,772,667	2,365,598	2,623,241	2,435,056
Allowance For Contract Losses	(8,540)	(10,040)	(8,540)	(10,040)	(14,135)	(16,715)	(19,676)
Reduction of REO to Fair Value	(527)	(1,020)	(527)	(1,020)	(2,300)	(2,592)	(3,050)
Total	(9,067)	(11,060)	(9,067)	(11,060)	(16,435)	(19,307)	(22,726)
BONDS PAYABLE							
General Obligation Bonds	(1,270,685)	(1,812,850)	(1,433,190)	(1,979,685)	(2,346,930)	(2,415,765)	(2,528,330)
Revenue Bonds	(575,845)	(627,835)	(617,445)	(521,475)	(548,210)	(570,940)	(505,815)
Total	(1,846,530)	(2,440,685)	(2,050,635)	(2,501,160)	(2,895,140)	(2,986,705)	(3,034,145)
OTHER CURRENT LIABILITIES	(21,679)	(20,233)	(22,312)	(19,261)	(90,047)	(60,081)	(87,598)
Net Lending & Financing Activities Assets	**252,613**	**275,553**	**260,203**	**291,971**	**306,799**	**305,349**	**289,155**
ASSETS AND LIABILITIES RELATED TO INSURANCE ACTIVITIES:							
LIFE AND DISABILITY COVERAGE							
Cash Reserve for Life and Disability	609	4,417	2,388	6,387	9,875	16,289	23,010
Insurance Loss Reserves	(17,600)	(19,900)	(17,600)	(19,900)	(22,653)	(26,726)	(31,642)
Total	(16,991)	(15,483)	(15,212)	(13,513)	(12,778)	(10,437)	(8,632)
RATE STABILIZATION RESERVE FOR LIFE AND DISABILITY PREMIUMS**	5,000	0	5,000	0	0	(5,700)	(5,700)
FIRE AND HAZARD COVERAGE							
Deposits with Insurance Administrators	1,050	1,850	1,850	1,850	1,850	1,850	1,850
Accrued Liabilities	(1,891)	(2,225)	(2,512)	(2,035)	(1,950)	(3,016)	(3,236)
Total	(841)	(375)	(662)	(185)	(100)	(1,166)	(1,386)
Net Insurance Activities Liabilities	**(12,832)**	**(15,858)**	**(10,874)**	**(13,698)**	**(12,878)**	**(17,303)**	**(15,718)**
RETAINED EARNINGS	**$ 239,781**	**$ 259,695**	**$ 249,329**	**$ 278,273**	**$ 293,921**	**$ 288,046**	**$ 273,437**
SUMMARY INFORMATION							
Total Assets	$ 2,127,000	$ 2,743,000	$ 2,342,000	$ 2,821,000	$ 3,304,000	$ 3,344,000	$ 3,411,000
Total Liabilities	$ 1,888,000	$ 2,483,000	2,093,000	$ 2,542,000	$ 3,010,000	$ 3,056,000	$ 3,137,000
Total # of Contracts of Purchase	17,643	20,130	18,699	22,397	28,605	32,473	33,440

*Surplus Money Investment Fund.

** Reclassification for Liabilities which was reversed in Fiscal Year 2002.

***6 Months unaudited financial information; GASB adjustments from prior fiscal year were made as of June 30, 2004 carried over and not updated.

SELECTED FINANCIAL DATA OF THE 1943 FUND
(Dollars in Thousands)

	6 Months Ending Dec. 31, 2004 ***	6 Months Ending Dec. 31, 2003 ***	For Fiscal Years Ending on June 30, 2004	June 30, 2003	June 30, 2002	June 30, 2001	June 30, 2000
NET INCOME FROM LENDING AND FINANCING ACTIVITIES:							
INTEREST INCOME							
Interest on Contracts	$ 46,509	$ 52,551	$100,676	$ 140,036	$ 166,086	$ 179,755	$ 150,213
Interest on Investments	8,553	14,314	23,613	34,142	38,107	40,194	69,471
Transfers of Interest From Veterans Debenture Revenue Fund	1,019	1,002	2,009	2,029	2,403	2,219	1,476
Total	56,081	67,867	126,298	176,207	206,596	222,168	221,160
BOND INTEREST EXPENSE	(56,230)	(73,204)	(136,882)	(169,143)	(184,654)	(188,017)	(193,495)
Net Interest Income	**(149)**	**(5,337)**	**(10,584)**	**7,064**	**21,942**	**34,151**	**27,665**
RESERVE FOR RATE STABILIZATION	0	0	0	0	0	0	(5,700)
GASB 31 ADJUSTMENT	215	532	215	532	554	351	479
GAIN ON SALE OF SECURITIES	0	0	0	0	0	1,130	270
RESTRUCTURING EXPENSES	(1,015)	(3,300)	(8,164)	(5,826)	(4,780)	(3,642)	(2,629)
Total	(800)	(2,768)	(7,949)	(5,294)	(4,226)	(2,161)	(7,580)
CONTRACTS OF PURCHASE							
PMI	(1,066)	(1,672)	(2,991)	(1,845)	(2,565)	(7,658)	(86)
Net gain (loss) on Sale of REO'S	254	887	1,173	2,092	1,730	55	(2,683)
(Increase) Decrease in Allowance for Contract Losses	0	0	1,993	5,375	2,872	3,420	6,641
Total	(812)	(785)	175	5,622	2,037	(4,183)	3,872
Net Lending/Financing Activities Income (Expense)	**(1,761)**	**(8,890)**	**(18,358)**	**7,392**	**19,753**	**27,807**	**23,957**
NET INCOME FROM ADMINISTRATIVE ACTIVITIES							
Operating Revenues	3,116	4,235	7,967	5,813	4,417	8,128	5,779
Operating Expenses	(10,194)	(11,302)	(21,918)	(25,396)	(20,353)	(21,541)	(23,902)
Net Administrative Activities Expense	**(7,078)**	**(7,067)**	**(13,951)**	**(19,583)**	**(15,936)**	**(13,413)**	**(18,123)**
NET INCOME FROM INSURANCE ACTIVITIES							
Life and Disability Coverage	(1,751)	(2,130)	4,194	(1,568)	896	(2,571)	(3,374)
Fire and Hazard Coverage	1,003	(149)	(829)	(1,889)	1,162	2,786	1,408
Net Insurance Activities Income (Expense)	**(748)**	**(2,279)**	**3,365**	**(3,457)**	**2,058**	**215**	**(1,966)**
TOTAL EXCESS (DEFICIENCY) OF REVENUES AND TRANSFERS OVER EXPENSES	**(9,587)**	**(18,236)**	**(28,944)**	**(15,648)**	**5,875**	**14,609**	**3,868**
RETAINED EARNINGS	$ 239,781	$ 259,695	$249,329	$ 278,273	$ 293,921	$ 288,046	$ 273,437

***6 Months unaudited financial information; GASB adjustments from prior fiscal year were made as of June 30, 2004 carried over and not updated.

Department's Discussion of Financial Data

Included as part of the financial statements contained in EXHIBIT 1 is the section entitled "Management's Discussion and Analysis of Financial Position and Results of Operations" which presents management's discussion in relation to the financial statements of the 1943 Fund for the fiscal year ended June 30, 2004 and in comparison to the financial statements for the fiscal year ended June 30, 2003 (the "Management Discussion and Analysis"). The Selected Financial Data is presented to provide a summary of the financial position and operations over a longer period of time, and a presentation of the significant changes that have occurred. Certain limited aspects of the Selected Financial Data are discussed below. This discussion should be read in conjunction with the Management Discussion and Analysis contained in APPENDIX B and EXHIBIT 2 thereto entitled "Certain Department Financial Information and Operating Data."

The Selected Financial Data reflects the onset in the second half of the fiscal year ended June 30, 2002 of adverse conditions in the capital market environment in which the 1943 Fund operates – historically low levels of interest rates on conventional mortgages, and even lower levels of interest rates on short term money market instruments. In part as a consequence of prepayments of Contracts of Purchase refinanced by lower rate conventional mortgages, and in part as a consequence of new originations of Contracts of Purchase lost to highly competitive conventional mortgages, Contracts of Purchase held under the 1943 Fund declined by $826,121,000 over the next two fiscal years, from $2,365,598,000 as of June 30, 2002 to $1,539,477,000 as of June 30, 2004. The impact of this shrinkage in the assets of the 1943 Fund was compounded by adverse turnover of the portfolio, with the more rapid prepayment of higher interest rate Contracts of Purchase, and the origination of new Contracts of Purchase at progressively lower interest rates. In the fiscal year ended June 30, 2002, the average interest rate on outstanding Contracts of Purchase was approximately 6.8%; in the fiscal year ended June 30, 2004, the average interest rate had fallen to approximately 6.4%.

Over the same two fiscal years, as a result of the use of significant amounts of prepayments and unexpended proceeds to redeem bonds, the balance of Veterans G.O. Bonds and Revenue Bonds payable from the 1943 Fund declined by $844,505,000, from $2,895,140,000 as of June 30, 2002, to $2,050,635,000 as of June 30, 2004. To a limited extent, the adverse turnover to the asset portfolio was offset by the Department's priority selection (subject to the requirements of the Resolution) of the higher interest rate Veterans G.O. Bonds for Special Redemption. In the fiscal year ended June 30, 2002, the average interest rate on all outstanding Veterans G.O. Bonds and Revenue Bonds was approximately 6.15%; in the fiscal year ended June 30, 2004, the average interest rate had fallen to approximately 6.00%.

The Department's ability to reduce the overall interest cost of Veterans G.O. Bonds and Revenue Bonds was limited by its inability to redeem any of the outstanding Veterans G.O. Bonds issued prior to 1986 (the "Non-Callable Bonds"). The Non-Callable Bonds, of which $592,055,000 and $459,970,000 were outstanding as of June 30, 2002 and June 30, 2004, respectively, mature in installments through October 1, 2010, and bear an average interest rate of over 9%. Notwithstanding this short term fixed repayment schedule, the early redemption of other Veterans G.O. Bonds resulted in the increase in the Non-Callable Bonds as percentage of the outstanding Veterans G.O. Bonds from approximately 25% as of June 30, 2002, to approximately 32% as of June 30, 2004. Exclusive of the Non-Callable Bonds, the average interest rate on outstanding Veterans G.O. Bonds and Revenue Bonds was approximately 5.35% in the fiscal year ended June 30, 2002, and had fallen to approximately 5.14% in the fiscal year ended June 30, 2004.

While the decline in the balance of Contracts of Purchase over the two year period was offset by a corresponding decline in the amount of Veterans G.O. Bonds and Revenue Bonds payable, repayments of Contracts of Purchase were invested in the 1943 Fund temporarily pending use for the payment or redemption of bonds (with Qualified Veterans Mortgage Bond Proceeds and Qualified Mortgage Bond Proceeds) or for the financing of new Contracts of Purchase (with Unrestricted Moneys). In the case of the Unrestricted Moneys, repayments significantly exceeded new originations over the two year period ended June 30, 2004, resulting in an accumulation of cash, much of which (generally amounts not related to bonds for federal tax purposes) was deposited in the SMIF. As of June 30, 2003, the total amount on deposit in the SMIF was $728,511,000, an increase of $213,459,000 over the amount on deposit as June 30, 2002 (which itself represented a significant increase over the prior year). As the deposits grew, the impact became increasingly negative as short term interest rates generally declined, and as the SMIF yields followed. In the fiscal year ended June 30, 2002, the average yield paid to depositors in SMIF was approximately 3.4%; in the fiscal year ended June 30, 2004, this average yield had fallen to approximately 1.5%.

The contraction of the balance sheet, the shift in the mix of assets, and the decline (or inversion) of the spreads between asset yields and bond rates have all contributed to a significant and rapid deterioration of the financial performance of the 1943 Fund over the two year period. These factors are directly reflected in net interest, which reversed from a net income of $21,942,000 for the year ended June 30, 2002 to a net loss of $10,584,000 for the year ended June 30, 2004. In addition, as a result of the increase in early redemption of Veterans G.O. Bonds and Revenue Bonds, non-cash amortization expense related to the previously expended costs of issuing and restructuring bonds has increased steadily from $4,780,000 for the year ended June 30, 2002, to $8,164,000 for the year ended June 30, 2004. Total excess (deficiency) of revenues and transfers over expenses has deteriorated correspondingly.

Notwithstanding the negative impact of the recent periods on retained earnings, which declined from $293,921,000 as of June 30, 2002 to $249,329,000 as of June 30, 2004, the amount of retained earnings of the 1943 Fund has continued to improve in relationship to outstanding assets and liabilities. The overall asset-to-liability ratio for the 1943 Fund increased steadily from 109.8% as of June 30, 2002, to 111.9 % as of June 30, 2004.

Since December 31, 2003, the financial performance of the 1943 Fund has benefited from both the improvement in the market environment and the implementation by the Department of additional strategies to mitigate that impact of adverse market conditions. As a result of less competitive conditions in the conventional mortgage market, the balance of Contracts of Purchase held under the 1943 Fund as of December 31, 2004 was unchanged from six months earlier, and had declined by only $33,185,000 from a year earlier. Interest rates on newly originated Contracts of Purchase had increased by approximately 90 basis points from their low at the start of the 2003/04 fiscal year. As a result of additional redemptions of bonds and originations of Contracts of Purchase, the amount on deposit in SMIF was down to $380,570,000 as of December 2004, from $829,375,000 a year earlier. By December 2004, the average yield paid on deposits in SMIF had recovered to 2%.

In August 2003, the Department implemented the practice of utilizing Unrestricted Moneys (otherwise on deposit in SMIF) to finance Contracts of Purchase on a temporary basis, against reimbursement from the proceeds of future sales of Qualified Veterans Mortgage Bonds or Qualified Mortgage Bonds. As a result, the Department has achieved an immediate increase in the return on such Unrestricted Moneys. In December 2003, the Department issued the 2003 Series A Revenue Bonds, in variable rate mode, to refund prior fixed rate bonds. As a result, the Department matched the interest cost on a portion of its bonds to the variable earnings rate on a portion of the cash that remained on deposit in the SMIF. For the six months ended December 31, 2004, the net interest loss for the 1943 Fund was reduced to $149,000, compared to the net interest loss of $5,337,000 for the six month period ended December 31, 2003.

The ability of the Department to return to an excess of revenues over expenses in future periods will depend upon a variety of factors including, among others: (a) the level of interest rates available on short-term investments (including the rate paid on SMIF and on newly acquired investment contracts) relative to the level of interest rates on outstanding bonds; (b) the rate of origination and the rate of prepayment of Contracts of Purchase, which will directly impact the amount of bond proceeds, recycling funds and revenues held in such investments; (c) the interest rates established from time to time by the Department for newly originated Contracts of Purchase relative to the interest cost on bonds issued to finance such Contracts of Purchase; (d) the interest rates on outstanding Contracts of Purchase relative to the interest cost on outstanding bonds, which will directly depend on the Department's ability to use special and optional redemption provisions to minimize the overall cost of outstanding debt (limited, over the near term by the Non-Callable Bonds); (e) the market prices that can be achieved upon the sale of repossessed properties relative to the then-outstanding contract balances; (f) the level of insurance premiums that the Department collects under its existing life and disability coverage plan and fire and hazard coverage plan relative to actual claims experience and costs (net of reinsurance); and (g) the level of administrative expenses relative to the rate of origination and outstanding balances of the Contracts of Purchase. The Department expects that there will be significant variations in results in future periods, including additional periods in which there will be a deficit of revenues over expenses.

Excess Revenues

The Department has covenanted with the holders of its Revenue Bonds to apply Revenues received with respect to Contracts of Purchase, after payment or reimbursement of debt service on Veterans G.O. Bonds, in a specified order of priority. The availability and use of Revenues can provide moneys for special redemption of the Offered Veterans G.O. Bonds (see "THE OFFERED VETERANS G.O. BONDS – Redemption – Special Redemption from Excess Revenues). For this purpose, "Revenues" means all moneys received by or on behalf of the Department representing (i) principal and interest payments on the Contracts of Purchase including all prepayments representing the same and all prepayment premiums or penalties received by or on behalf of the Department in respect to the Contracts of Purchase, (ii) interest earnings received on the investment of amounts to the extent deposited in the revenue account established under the Revenue Bond Resolution, (iii) amounts transferred to the revenue account from the bond reserve account or the loan loss amount established under the Revenue Bond Resolution, and (iv) any other amounts payable by parties executing Contracts of Purchase or private participants in the Program or related to recoveries on defaulted Contracts of Purchase, including origination and commitment fees, servicing acquisition fees, liquidation proceeds, and insurance proceeds, *except* to the extent not included as "Revenues" pursuant to the provisions of any resolution authorizing the issuance of a series of Revenue Bonds.

The Department has covenanted with the Revenue Bond holders to administer the 1943 Fund and the Program and perform its obligations to such holders in accordance in all material respects with the then-current Program Operating Procedures. The Program Operating Procedures are operating policies of the Department governing the discretionary activities of the Department under the Revenue Bond Resolution. The Department may amend the Program Operating Procedures. The Program Operating Procedures will affect the Excess Revenues that will become available to redeem the Offered Veterans G.O. Bonds.

The Department has covenanted with the Revenue Bond holders to apply Revenues in the following order, after paying, or reimbursing for payments of, debt service on Veterans G.O. Bonds, including the costs of liquidity and credit enhancement facilities related thereto, and setting aside moneys as required under the Federal Tax Code to preserve the tax-exempt status of certain Veterans G.O. Bonds and Revenue Bonds, (1) to pay debt service on Revenue Bonds, (2) to pay the costs associated with liquidity and credit enhancement facilities, if any, for Revenue Bonds, (3) to replenish certain reserve funds established for the Revenue Bonds, (4) if the Department elects, to pay Department expenses, (5) to set aside a monthly accrual of Veterans G.O. Bond debt service, (6) if the Department elects, to finance Contracts of Purchase, and (7) with respect to Excess Revenues and certain tax restricted moneys, to redeem Veterans G.O. Bonds, including the Offered Veterans G.O. Bonds, and Revenue Bonds. For such purposes:

(a) "Excess Revenues" means, as of any date of calculation, Revenues in excess of Accrued Debt Service;

(b) "Accrued Debt Service" means, as of any date of determination and, as the context requires, with respect to all Revenue Bonds and Veterans G.O. Bonds (including the Offered Veterans G.O. Bonds), the sum of:

(i) the aggregate amount of scheduled interest and principal (except to the extent otherwise to be redeemed pursuant to clause (ii) or (iii) below) to become due after such date but on or before the end of the current debt service year, *less* the product of (x) the number of whole months remaining in the current debt service year and (y) the Monthly Debt Service Requirement;

(ii) the redemption price of bonds for which notice of redemption has been issued, provided such redemption price is to be paid from amounts on deposit in the revenue account created under the Revenue Bond Resolution; and

(iii) the redemption price of bonds that the Department will be obligated to redeem prior to the end of the next succeeding debt service year, to the extent that such obligation arises on account of amounts on deposit in such revenue accounts; and

(c) "Monthly Debt Service Requirements" means, as of any date of determination, one-twelfth of the aggregate amount of scheduled interest and principal to become due during the debt service year in which such date falls, as computed on the first day of such debt service year.

Maintenance of Fund Parity

The Revenue Bond Resolution requires the Department to calculate "Fund Parity" at least annually. "Fund Parity" means (a) an amount equal to the difference between (i) all assets in the 1943 Fund and in the accounts established under the Revenue Bond Resolution, and (ii) the principal amount of all Revenue Bonds and Veterans G.O. Bonds outstanding (plus accrued interested reduced by (b) defined allowances and reserves for loss coverage on Contracts of Purchase and life and disability coverage on persons obligated under Contracts of Purchase. If any such calculation shall not reflect that Fund Parity at least equals the percentage required by the Revenue Bond Resolution, the Department may be required to expend Excess Revenues to redeem Revenue Bonds until its recalculations of Fund Parity meet the test required by the Revenue Bond Resolution. Currently the applicable required percentage of Fund Parity is 25%. Such applicable percentage has been subject to rating agency confirmation.

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EXHIBIT 1
FINANCIAL STATEMENTS OF THE 1943 FUND
FOR FISCAL YEARS 2004 AND 2003
AND INDEPENDENT AUDITORS' REPORT
VETERANS FARM AND HOME BUILDING FUND OF 1943,
DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA

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Veterans Farm And Home Building Fund Of 1943, Department Of Veterans Affairs, State Of California

Financial Statements for the Years Ended June 30, 2004 and 2003 and Independent Auditors' Report

VETERANS FARM AND HOME BUILDING FUND OF 1943, DEPARTMENT OF VETERANS AFFAIRS

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INDEPENDENT AUDITORS' REPORT

California Veterans Board
State of California
Sacramento, California

We have audited the accompanying balance sheets of the Veterans Farm and Home Building Fund of 1943, which is administered by the Department of Veterans Affairs of the State of California (the "Department") as of June 30, 2004 and 2003, and the related statements of revenues, expenses and changes in fund equity and of cash flows for the years then ended. These financial statements are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Veterans Farm and Home Building Fund of 1943, and are not intended to present the financial position of the Department of Veterans Affairs of the State of California or the results of its operations and cash flows of its proprietary funds.

In our opinion, such financial statements referred to above present fairly, in all material respects, the financial position of the Veterans Farm and Home Building Fund of 1943, Department of Veterans Affairs of the State of California as of June 30, 2004 and 2003, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America

Management's Discussion and Analysis on pages 2 through 5 is not a required part of the financial statements, but is supplementary information required by the GASB. This supplementary information is the responsibility of the Department's management. We have applied certain limited procedures, which consisted primarily of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and we do not express an opinion on it.

Deloitte + Touche LLP

October 12, 2004

Management's Discussion and Analysis of Financial Position and Results of Operations

The Department of Veterans Affairs (the "Department") began making low interest rate farm and home financing available to veterans after World War I, following the enactment by the California Legislature of the Veterans Farm and Home Purchase Act of 1921 (the "Cal-Vet Farm and Home Program" or the "Program"). In 1943, the Legislature enacted the Veterans Farm and Home Purchase Act of 1943 which modified the Program to meet new needs of California's veterans. The 1943 Act established the 1943 Fund in the State Treasury and the Department established the Veterans Farm and Home Building Fund of 1943 (the "Fund"), which is the principal fund utilized for the Cal-Vet Farm and Home Loan Program. Financing is provided as installment loans, which are referred to as Contracts of Purchase.

The sales of the Fund's Home Purchase Revenue Bonds and Veterans General Obligations Bonds combined with monies received from prepayments of Contracts of Purchase and other revenues under the Program not needed at any given time to meet the then current bond retirement schedules and operating costs have financed the purchase of farms and homes since the Program's inception. Expenditures are primarily for debt service and administration of the Program.

The enclosed financial statements present the Fund's balance sheets, statements of revenues, expenses and changes in fund equity and cash flows. The following is a condensed summary of financial information for the years ended June 30, 2004 and 2003, respectively.

Condensed Financial Information (In thousands of dollars)

Balance Sheets

Condensed Balance Sheet	2004	2003	% Change
Assets:			
Cash and investments	$ 753,782	$ 1,002,343	(24.80)%
Receivables under contracts of purchase—net	1,527,950	1,756,379	(13.01)%
Other receivables and assets	60,656	61,907	(2.02)%
Total	$2,342,388	$2,820,629	(16.96)%
Liabilities:			
Bonds payable	$2,039,554	$2,482,695	(17.85)%
Other payables and liabilities	53,505	59,661	(10.32)%
Total	2,093,059	2,542,356	(17.67)%
Fund Equity	249,329	278,273	(10.40)%
Total	$2,342,388	$2,820,629	(16.96)%

Total assets decreased $478.2 million from $2.82 billion at June 30, 2003 to $2.34 billion at June 30, 2004. This decrease consisted primarily of the following items:

Total cash and investments decreased $246 million from $1 billion at June 30, 2003 to $754 million at June 30, 2004. This decrease is the direct result that the Department used excess cash to redeem bonds.

Net receivables under contracts of sale decreased $228.4 million from $1.8 billion at June 30, 2003 to $1.5 billion at June 30, 2004. This decrease is principally the result of the current low interest rate environment. During the fiscal year, many contract holders refinanced their loans to lower interest rates with other financial institutions.

All other assets decreased $1.2 million from $61.9 million at June 30, 2003 to $60.7 million at June 30, 2004. This net decrease was primarily due to a reduction in the inventory of repossessed properties, a decrease in interest receivables brought about by the increased prepayments of higher yielding Contracts of Sale rates into lower yielding investments and a one time positive adjustment of $6.4 million from the Life and Disability Program. Without the one time adjustment all other assets decreased $7.7 million over the prior fiscal year.

Bonds payable and other payables and liabilities decreased $449.0 million from $2.54 billion at June 30, 2003 to $2.09 billion at June 30, 2004. This net decrease is primarily the result of the early redemption of bonds using excess cash.

Fund equity decreased by $29 million from $278.3 million at June 30, 2003 to $249.3 million at June 30, 2004 as a result of the excess of expenses over revenues of $29 million.

The total asset to liability ratio for the Fund was at 1.12 at June 30, 2004 and 1.11 at June 30, 2003.

Revenues, Expenses and Changes in Fund Equity

Condensed Statements of Revenues, Expenses and Changes in Fund Equity

	2004	2003	% Change
PROGRAM OPERATIONS:			
Interest revenues:			
Contracts of purchase	$ 100,676	$ 140,036	(28.11)%
Investments and other	25,837	36,703	(29.61)%
Total program operating revenues	126,513	176,739	(28.42)%
Expenses:			
Interest expense	145,046	174,969	(17.10)%
Other expenses	(1,993)	(5,375)	(62.92)%
Total program operating expenses	143,053	169,594	(15.65)%
(Deficiency) excess of program operations revenue (under) over program operations expense	(16,540)	7,145	(331.49)%
PROGRAM ADMINISTRATION:			
Total program administration revenues	7,138	3,924	81.91 %
Total program administration expenses	20,715	28,809	(28.10)%
Excess of program administration revenue over program administration expense	(13,577)	(24,885)	(45.44)%
Gain on sale of repossessed property	1,173	2,092	(43.93)%
Deficiency of revenues over expenses	$ (28,944)	$ (15,648)	84.97 %

Program Operations

Interest revenue from Contracts of Purchase decreased by $39.4 million from $140.0 million for the year ended June 30, 2003 to $100.6 million for the year ended June 30, 2004, principally due to the decline of the Program's loan portfolio.

Interest revenues on investments decreased by $10.9 million from $36.7 million for the year ended June 30, 2003 to $25.8 million for the year ended June 30, 2004. This decrease is due to the current historically low interest rates of the State's Surplus Money Investment Fund ("SMIF"), in which a majority of the program's cash is invested. Additionally, cash balances decreased due to early redemption of bonds.

Interest expense decreased by $30 million from $175 million for the year ended June 30, 2003 to $145 million for the year ended June 30, 2004. The decrease is due to the significant reduction of outstanding bonds as a result of early redemptions of bonds. In addition, the Department refunded

$124 million of bonds from higher yielding long term fixed rate to lower yielding variable rate bonds.

Program operation revenues for the fiscal year are deficient by $16.5 million compared to an excess of $7.1 million for the prior fiscal year. The decrease of $23.6 million is due to high contract prepayments and refinancing activities, which resulted in a shift of assets from higher yielding contracts of purchase to lower yielding short term SMIF investments. The other contributing factor is the interest expense from the $460 million of high yield, non-callable bonds which could not be reduced from bond redemptions due to its non-callable nature.

Program Administration

Program administration revenues include loan origination fees paid to the Department, loan guarantee fees collected by the Department to be applied, in part, to the purchase of private mortgage insurance, other miscellaneous fees collected from program participants, rental income, and certain reimbursements of prior expenses, among others. Revenues increased by $3.2 million from $3.9 million for the year ended June 30, 2003 to $7.1 million for the year ended June 30, 2004. The increase is mainly the result of fees collected from higher volume of loan originations.

Total program administration expenses decreased $8.1 million from $28.8 million for the year ended June 30, 2003 to $20.7 million for the year ended June 30, 2004. The decrease is due to three factors: (1) Payroll and related expenses decreased by $0.7 million as the Department cut staff levels, (2) General and administrative expenses decreased by $1.7 million as many of the Department's cost control measures took effect and (3) The Self-Insured Life and Disability program produced a profit of $4.2 million for the fiscal year as compared to a loss of $1.6 million for the prior fiscal year. This program improvement is principally due to a one-time refund of $6.0 million from the insurance company, Pacific Life and Annuity.

Gain on Sale of Repossessed Properties decreased $0.92 million from the last fiscal year. This decrease is due to reduced sales of repossessed properties as the Department's holdings of these properties went from $5.2 million as of June 30, 2003 to $2.5 million as of June 30, 2004.

VETERANS FARM AND HOME BUILDING FUND OF 1943, DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA

BALANCE SHEETS
JUNE 30, 2004 AND 2003 (in thousands)

	2004	2003
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents:		
Cash In State Treasury	$ 9,756	$ 12,660
State of California's Surplus Money Investment Fund	582,286	722,238
Total cash and cash equivalents	592,042	734,898
Receivables under contracts of purchase, net of allowance for uncollectible contracts of $8,540 in 2004 and $10,040 in 2003	1,527,950	1,756,379
Interest receivable:		
Contracts of purchase	7,446	10,076
State of California's Surplus Money Investment Fund	2,272	3,141
Other investments	786	1,300
Total current assets	2,130,496	2,505,794
Noncurrent assets:		
Investments:		
Guaranteed investment contracts	154,890	265,595
Insurance administrators	6,850	1,850
Total investments	161,740	267,445
Due from Veterans Debenture Revenue Fund	37,532	37,411
Other real estate owned, net of allowance for losses of $527 in 2004 and $1,020 in 2003	2,460	5,228
Land, improvements and equipment—net of accumulated depreciation of $12,713 in 2004 and $11,732 in 2003	3,398	4,372
Other	6,762	379
Total noncurrent assets	211,892	314,835
TOTAL	$2,342,388	$2,820,629
LIABILITIES AND FUND EQUITY		
CURRENT LIABILITIES:		
Bonds payable—current portion	$ 229,650	$ 156,205
Accrued interest and other liabilities	33,209	37,439
Due to other funds	847	287
Total current liabilities	263,706	193,931
Noncurrent liabilities:		
Bonds payable—noncurrent portion	1,809,904	2,326,490
Insurance claims payable and loss reserves	19,449	21,935
Total noncurrent liabilities	1,829,353	2,348,425
Total liabilities	2,093,059	2,542,356
FUND EQUITY—Unrestricted	249,329	278,273
TOTAL	$2,342,388	$2,820,629

See notes to financial statements.

VETERANS FARM AND HOME BUILDING FUND OF 1943, DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND EQUITY YEARS ENDED JUNE 30, 2004 AND 2003 (in thousands)

	2004	2003
PROGRAM OPERATIONS:		
Interest revenues:		
Contracts of purchase of properties	$ 100,676	$ 140,036
Investments and other	23,828	34,674
Transfers of revenue from Veterans Debenture Revenue Fund	2,009	2,029
Total program operations revenues	126,513	176,739
Expenses:		
Interest expense	145,046	174,969
Reversal of allowance for uncollectible contracts	(1,993)	(5,375)
Total program operations expenses	143,053	169,594
Excess (deficiency) of program operations revenues over program operations expenses	(16,540)	7,145
PROGRAM ADMINISTRATION:		
Revenues:		
Loan fees	6,669	3,625
Other income	1,298	2,188
Deficiency of amounts charged to contract holders over fire and hazard insurance claims and expenses and changes in insurance reserves	(829)	(1,889)
Total program administration revenues	7,138	3,924
Expenses:		
Payroll and related costs	13,050	13,660
General and administrative expenses	11,859	13,581
(Excess) deficiency of self-insured life and disability insurance claims and expenses and changes in insurance reserves over amounts charged to contract holders	(4,194)	1,568
Total program administration expenses	20,715	28,809
Excess of program administration expenses over program administration revenues	(13,577)	(24,885)
NONOPERATING REVENUE—Gain on sale of repossessed property	1,173	2,092
Excess (deficiency) of revenues over (under) expenses	(28,944)	(15,648)
FUND EQUITY:		
Beginning of year	278,273	293,921
End of year	$ 249,329	$ 278,273

See notes to financial statements.

VETERANS FARM AND HOME BUILDING FUND OF 1943, DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA

STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2004 AND 2003 (in thousands)

	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts from contractholders	$ 13,211	$ 11,995
Interest received	130,775	182,842
Interest payments	(140,292)	(174,601)
Payments to suppliers and employees	(13,110)	(43,462)
Other (payments) receipts	(16,862)	6,322
Net cash used for operating activities	(26,278)	(16,904)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net decrease in receivables under contracts of purchase	229,929	589,636
Net decrease in investment securities	105,705	107,965
Purchase of land, improvements and equipment	(7)	(71)
Net cash provided by investing activities	335,627	697,530
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Proceeds from sales of bonds	124,635	-
Maturities of bonds payable	(74,490)	(72,315)
Early redemption of bonds payable	(483,380)	(321,665)
Net decrease in Due from Veterans Debenture Revenue Fund	(121)	(65)
Additions to deferred financing costs	(779)	-
Additions to commercial paper from maturities of bonds payable	(18,070)	(66,735)
Net cash used for noncapital financing activities	(452,205)	(460,780)
(DECREASE) INCREASE IN CASH IN STATE TREASURY	(142,856)	219,846
CASH IN STATE TREASURY:		
Beginning of year	734,898	515,052
End of year	$ 592,042	$ 734,898
RECONCILIATION OF OPERATING INCOME TO NET CASH USED BY OPERATING ACTIVITIES:		
Dificiency of revenues under expenses	$ (28,944)	$ (15,648)
Adjustments to reconcile to net cash used by operating activities:		
Bond amortization	8,164	5,826
Reversal of allowance for uncollectible contracts	(1,993)	(5,375)
Depreciation	981	1,260
Gain on sale of repossessed property	(1,173)	(2,092)
Effect of changes in assets and liabilities:		
Interest receivable - State of California's Surplus		
Increase in Money Investment Fund	869	901
Increase in interest receivable— other investments	514	461
Increase in interest receivable— contracts of purchase	2,630	4,741
Increase in other real estate owned	5,213	5,387
(Decrease) increase in other assets	(6,383)	180
Decrease in accrued interest and other liabilities	(4,229)	(7,214)
Increase (decrease) in due to other funds	559	(2,557)
Increase in insurance claims payable and loss reserves	(2,486)	(2,774)
NET CASH USED BY OPERATING ACTIVITIES	$ (26,278)	$ (16,904)

See notes to financial statements.

VETERANS FARM AND HOME BUILDING FUND OF 1943, DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA

NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2004 AND 2003

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Description—The California Department of Veterans Affairs (the "Department") is a separate legal entity and a Cabinet level agency of the State of California. A seven-member California Veterans Board (the Board) has policy oversight of the operations of the Department, all of whom are appointed by the Governor, subject to confirmation by the State Senate. The Veterans Farm and Home Building Fund of 1943 (the Fund) was established under the authority of the California Constitution to provide low-interest, long-term farm and home mortgage loan contracts to veterans living in California. The contract loan program has been continuous since 1922. Proceeds from the sale of general obligation bonds, periodically authorized by the vote of the people of California, and revenue bonds authorized by the Legislature are used for contract loans to veterans. Expenses are primarily for debt service and administration of the program. The Fund is tax exempt.

The financial statements represent only the activities of the Veterans Farm and Home Building Fund of 1943, and are not intended to present the financial position of the Department of Veterans Affairs of the State of California and the results of its operations and cash flows of its proprietary funds. The financial statements of the Fund are included in the financial statements of the State of California as the State represents the primary government and has ultimate oversight responsibility for the Fund.

Use of Estimates in the Preparation of Financial Statements—The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Basis of Accounting—The Fund has been classified as a proprietary fund for accounting purposes. Revenues are recorded when earned and expenses are recognized as incurred.

Governmental Accounting Standards Board Statement No. 20 (GASB No. 20), *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Funds Accounting*, established standards for accounting and financial reporting for proprietary funds. In accordance with GASB No. 20, the Fund's proprietary fund accounting and financial reporting practices are based on all applicable GASB pronouncements as well as the following pronouncements issued on, or before, November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements: Financial Accounting Standards Board ("FASB") Statements and Interpretations, Accounting Principles Board ("APB") Opinions, and Accounting Research Bulletins ("ARBs") of the Committee on Accounting Procedures.

Investments—The Department reports all investments at fair value except for certain nonparticipating fixed interest investment contracts which are valued using cost based measures. The fair value of investments is based on published market prices and quotations from major investment brokers and from the State of California for the Surplus Money Investment Fund. Uncommitted bond proceeds for loans to veterans are reflected in the balance sheet within the investments balance.

Receivables under Contracts of Purchase—Receivables under contracts of purchase consist of the remaining contract principal balance net of the reserve for uncollectible accounts.

Allowance for Uncollectible Contracts—The allowance for uncollectible contracts is established through a provision charged to operations. The allowance is an amount that management believes will be adequate to absorb losses inherent in existing contracts and commitments to extend credit, based on evaluations of the collectibility and prior loss experience of contracts and commitments to extend credit. The evaluations take into consideration such factors as changes in the nature and volume of the portfolio, overall portfolio quality, specific problem contracts, commitments, and current and anticipated economic conditions that may affect the borrowers' ability to repay the obligation.

Contract Guarantees and Primary Mortgage Insurance—The Department collects a contract guarantee fee on all contracts with down payments less than 20%. Such contracts are classified as high loan to value ("HLTV") contracts. For eligible borrowers, the fee is used to purchase contract guarantees from the U.S. Department of Veterans Affairs ("USDVA") or primary mortgage insurance. For certain HLTV contracts not eligible for USDVA guarantees, the Fund purchases primary mortgage insurance ("PMI") from Radian Guaranty Inc., formerly, the Commonwealth Mortgage Assurance Company. The PMI provides lifetime coverage on the HLTV contracts, not covered by USDVA guarantees, subject to an aggregate 2% deductible. The Department is responsible for any losses not covered by the USDVA guarantees or the PMI.

Other Real Estate Owned—Real estate acquired by repossession is carried at the lower of the contract balance or its net realizable value. After repossession, the value of the underlying contract is written down to the estimated fair value of the real estate, if necessary. Any subsequent write-downs are charged against operating expenses. Operating expenses of such properties, net of any related income, are included in other expenses.

Insurance Claims Payable and Loss Reserves—Insurance claims payable and loss reserves include unpaid claims, incurred but not reported claims and loss reserves for the fire and hazard insurance plan and the remaining benefits payable under the Department's former self-insured life and disability protection plan.

Fire and Hazard Insurance—This insurance program is provided to eligible contract holders as part of the loan program. The difference between premiums charged to contract holders and claims and expenses incurred and the change in loss reserves is included as a net amount in the statement of revenues, expenses and changes in retained earnings.

Self-Insured Life and Disability Protection Plan—Beginning in 1984, the Department operated a self-funded protection plan whereby life and disability insurance was provided to eligible contract holders. This plan was terminated June 1, 1996. The life and disability benefits previously available to these members under the self-insured protection plan continue to be available to those contract holders who were receiving benefits at the time the plan was terminated. Loss reserves to satisfy these obligations of the protection plan which include future disability and life benefits were derived from an actuarial evaluation performed in 2001 that is updated internally on an annual basis. Significant actuarial assumptions and methodologies used to calculate the reserve are interest, mortality, disability, prepayment, and a long-term discount rate of 7%.

Amortization of Bond Premiums, Discounts and Issuance Costs—Premiums and discounts arising from the issuance of bonds and expenses incurred in connection with the issuance of bonds are capitalized and amortized using the monthly amortization method, which approximates the interest method.

2. CASH AND INVESTMENTS

Cash in the State Treasury represents amounts held in the Fund's general operating accounts with the State Treasury. These monies are pooled with the monies of other State agencies and invested by the State Treasurer's office. These assets are not individually identifiable.

Investment of bond funds is restricted by applicable California law and the various bond resolutions associated with each issuance, generally, to certain types of investments, including direct obligations of the U.S. Government and its agencies, the State of California's Surplus Money Investment Fund, and investment agreements with financial institutions or insurance companies rated within the top two ratings of a nationally recognized rating service. The investments with the insurance administrator, held as a deposit in accordance with a master agreement for the remaining active life and disability insurance program for disabled contract holders, is authorized by California law.

The Fund's investments in investment agreements totaling $154,890,000 and $265,595,000 as of June 30, 2004 and 2003, respectively, are carried at cost. The interest rates on investment agreements are fixed and range from 5.30% to 7.055%. The investment agreements expire from 2005 to 2032.

All of the Fund's investments in U.S. Treasury notes and bonds, corporate bonds, and the amounts administered by the insurance company are categorized as risk category 1, which is defined by GASB Statement No. 3 as investments that are insured or registered or for which the securities are held by the Fund or its agent in the Fund's name. In accordance with GASB Statement No. 3, the Fund's investments held in the State of California's Surplus Money Investment Fund and the investment agreements are not categorized as to risk.

The Fund's investments at June 30, 2004 and 2003 are as follows (in thousands):

	2004	2003
Category 1		
Amounts held in trust fund with insurance administrators	$ 6,850	$ 1,850
Investments Not Subject to Categorization		
Investment agreements (at cost)	154,890	265,595
Total	$ 161,740	$ 267,445

3. **RECEIVABLES UNDER CONTRACTS OF PURCHASE**

The Fund retains title to all real property subject to contracts of purchase until the contract is satisfied. The veteran's contracts have original terms of 25-30 years and bear interest at rates of 4.25% to 9.75%, depending on the age and type of contract and the classification of the contract holder.

4. **LAND, IMPROVEMENTS AND EQUIPMENT**

As of June 30, land, improvements and equipment consisted of the following:

	2004	2003
Land	$ 443,531	$ 443,531
Buildings	12,409,774	12,409,774
Equipment	3,257,564	3,250,630
	16,110,869	16,103,935
Less accumulated appreciation	12,712,764	11,732,344
Land, improvements and equipment, net	$ 3,398,105	$ 4,371,591

5. **BONDS PAYABLE**

At June 30, 2004 and 2003, bonds payable included the following (in thousands):

	2004	2003
General obligation bonds of the State of California, annual interest rates from 3.6% to 11.0% due in varying annual installments through 2032 (subject to varying redemption provisions)	$1,433,190	$1,979,685
Home purchase revenue bonds, annual interest rates from 1.37% to 6.15%, due in varying annual installments through 2028 (subject to varying redemption provisions)	617,445	521,475
Total	2,050,635	2,501,160
Less—discounts	(617)	(770)
Unamortized bond origination costs	(9,291)	(13,081)
Unamortized bond redemption premiums	(1,173)	(4,614)
Total	2,039,554	2,482,695
Less—current portion	229,650	156,205
Noncurrent portion	$1,809,904	$2,326,490

A summary of debt service requirements for the next five years and to maturity is as follows (in thousands):

Fiscal Year Ending June 30	Principal	Interest
2005	$ 229,650	$ 112,684
2006	81,720	104,787
2007	85,690	97,620
2008	91,655	89,694
2009	88,550	81,861
2010-2014	226,865	339,444
2015-2019	447,665	254,672
2020-2024	390,985	144,812
2025-2029	297,530	62,939
2030-2033	110,325	12,505
Total	$2,050,635	$1,301,018

General obligation bonds of the State of California are payable in accordance with the various veterans bond acts by the State General Fund. The full faith and credit of the State of California is pledged for the payment of both principal and interest. All general obligation bonds have an equal claim against the General Fund of the State of California. These bonds are included as obligations of the Fund when the proceeds from bond sales are received. The repayment for the bonds is the responsibility of the Fund. Authorized and unissued bonds under the Veterans Bond Acts of 1996 and 2000 were $605,585,000 at June 30, 2004 and 2003.

Home Purchase Revenue bonds are special obligations of the Department payable solely from, and by a pledge of, an undivided interest in the assets of the Veterans Farm and Home Building Fund of 1943 and the Veterans Debenture Revenue Fund, a separate fund of the Department. The undivided interest in the net revenues of the 1943 Fund is secondary and subordinate to any interest or right in the 1943 Fund of the people of the State of California and of the holders of general obligation veterans bonds. At any point in time, authorized and unissued revenue bonds equal the $1.5 billion ceiling authorized in 1987 less revenue bonds outstanding at that time. At June 30, 2004 and 2003, authorized and unissued revenue bonds were $882,555,000 and $978,525,000, respectively.

During fiscal year 1998, the Department amended the revenue bond resolution provisions regarding the Bond Reserve Account in the Veterans Debenture Revenue Fund (a separate entity). The revenue bond resolution requires the establishment and maintenance of a Bond Reserve Account in an amount equal to at least three percent of the aggregate outstanding principal amount of all Revenue Bonds with interest rates fixed to maturity. To calculate the reserve requirement, the Ninth Supplemental Resolution established, with respect to the revenue bonds with interest rates fixed to maturity issued pursuant to such resolution (1997 Series A, B and C Bonds, 1998 Series A Bonds, 1999 Series A and B Bonds, 2000 Series A, B and C Bonds, and 2001 Series A Bonds), a requirement equal to at least seven percent of the outstanding principal amount of such Revenue Bonds, and for series 2002 an amount equal to five percent of the outstanding principal amount. Amounts in the Bond Reserve Account shall be used solely for the purposes of paying the principal of and the interest on the Revenue Bonds and for making Mandatory Sinking Fund Account Payments on Revenue Bonds. Amounts on deposit in the Bond Reserve Account as of any date, in excess of the bond reserve requirement, may be transferred out of the Veterans Debenture Revenue Fund to the Fund, at the request of the Department. Investment earnings of the Veterans Debenture Revenue Fund are transferred to the Fund. At June 30, 2004 and 2003, the total assets of the Veterans Debenture Revenue Fund are shown as a receivable of the Fund. Complete financial statements of the Veterans Debenture Revenue Fund, Department of Veterans Affairs, State of California can be obtained by contacting the California Department of Veterans Affairs.

6. BOND REFUNDING

During fiscal year 2004, the Department issued Home Purchase Revenue bonds totaling $124,635,000 with variable interest rates. The interest rate for the new issue is 1.11% as of June 30, 2004. Bond proceeds from the Home Purchase Revenue bond issues were used to refund previously issued General Obligation bonds of $124,635,000. The Department did not issue any General Obligation bonds during the fiscal 2004.

7. FIRE AND HAZARD INSURANCE

Fire and hazard insurance coverage is provided on behalf of contract holders for substantially all properties subject to contracts of sale. The program is funded by amounts charged to contract holders which are considered appropriate to cover losses incurred, premiums paid for excess insurance coverage and administration fees. From the amounts charged to contract holders, the Department pays losses up to $1,500,000 per occurrence or $12,000,000 per policy year. Coverage in excess of the above amounts is provided under a master policy with an insurance carrier which also administers the program. The loss reserve is based on the third party administrator's estimate of incurred but not reported claims based on the historical trends and loss experience within the portfolio.

The excess of premiums charged to contract holders over claims, expenses and change in loss reserves for the year ended June 30, 2004 and 2003 was as follows (in thousands):

	2004	2003
Amounts charged to contract holders	$ 6,159	$ 7,272
(Less) plus:		
(Increase) decrease in estimated loss reserve	(253)	113
Claims loss expense	(5,702)	(7,916)
Master policy premium	(556)	(880)
Administrative fees	(477)	(478)
Deficiency of amounts charged to contract holders over claims and expenses and changes in reserves	$ (829)	$ (1,889)

8. SELF-INSURED LIFE AND DISABILITY PROTECTION PLAN

The Department was responsible for a self-insured life and disability protection plan for all contract holders until June 1, 1996. Except for existing contract holders receiving benefits at that date, the self-insured life and disability protection plan was replaced by existing life and disability insurance plans provided by commercial insurers.

As of June 30, 2004, the Department remains self-insured for approximately 458 remaining contract holders. Under the provisions of the self-insured plan benefits continue until the beneficiary returns to active employment, dies or their contract is paid off. Loss reserves for these obligations have been actuarially determined.

The excess of claims expenses, changes in loss reserves, and administrative expenses over plan revenues whose coverages continue as obligations of the self-funded life and disability protection plan for the years ended June 30, 2004 and 2003 was as follows (in thousands):

	2004	2003
Claims expenses:		
Life insurance program	$ (406)	$ (209)
Disability insurance program	(3,788)	(4,133)
Total claims expenses	(4,194)	(4,342)
Decrease in estimated loss reserves	8,300	2,753
Net claims expenses and change in loss reserves	4,106	(1,589)
Plus plan revenues:		
Life insurance program	46	60
Disability insurance program	93	107
Total	139	167
Less administrative fees	(51)	(146)
Excess (deficiency) of plan revenues over (under) net claims expense	$ 4,194	$ (1,568)

9. COMMITMENTS AND CONTINGENCIES

As of June 30, 2004 and 2003, the Fund had loan commitments to veterans for the purchase of properties under contracts of sale of approximately $161,681,815 and $63,965,075, respectively.

The Fund leases several buildings used as district offices. Rent expense for the years ended June 30, 2004 and 2003 was $349,342 and $367,976, respectively. Lease terms generally range from five to ten years with options to renew for additional periods. As of June 30, 2004, minimum annual rentals under operating leases are as follows (in thousands):

2005	$ 224
2006	209
2007	214
2008	180
2009	104
2010	54
Total	$ 985

10. RETIREMENT PLAN

Plan Description - The Fund contributes to the Public Employees' Retirement Fund ("PERF") as part of the State of California, the primary government. The PERF is a cost-sharing multiple-employer defined benefit pension plan administered by the California Public Employment Retirement System ("CalPERS"). CalPERS provides retirement, death, disability and post retirement health care benefits to members as established by state statue. CalPERS issues a publicly available Comprehensive Annual Financial Report ("CAFR") that includes financial statements and required supplementary information for the Public Employees' Retirement Fund. A copy of that report may be obtained from CalPERS, Central Supply, P.O. Box 942715, Sacramento, CA 95229-2715 or via the internet at www.calpers.ca.gov.

Funding Policy - Contributions to the Plan are funded by both the Department and the employee, and are actuarially determined by CalPERS based on covered compensation. State employees, with the exception of employees in the second-tier plan, are required to contribute to the fund. The contribution rates of active plan members are based 5% of compensation in excess of $513 each month. The employee contribution rate was reduced to zero for fiscal years 2004 and 2003 as part of a bargaining unit contract.

Contributions by the Department to the Plan for the years ended June 30, 2004 and 2003 were approximately $1,349,000 and $718,000, or approximately 14.4% and 6.7% of participants' salaries, respectively. No employee contributions were made in fiscal year 2004 and 2003, due to the reduction in the employee contribution rate to zero for fiscal years 2004 and 2003.

Annual Pension Cost - For Department's annual pension cost was equal to the Department's required and actual contributions. Required contribution is determined by actuarial valuation using the entry age normal actuarial cost method. The most recent actuarial valuation available is as of June 30, 2001 which actuarial assumptions included (a) 8.25% investment rate of return compounded annually, (b) projected salary increases that vary based on duration of service, and (c) overall payroll growth factor of 3.75% annually. Both (a) and (b) included an inflation component of 3.5% and a .25 percent per annum productivity increase in consumption. The actuarial value of CalPERS assets attributable to the Department was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a two to five-year period.

Three-Year Trend Information for the Plan

Three-Year Fund Trend Information

Fiscal Year End	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
June 30, 2001	$ 375,000	100%	$ -
June 30, 2002	$ 718,000	100%	$ -
June 30, 2003	$ 1,349,000	100%	$ -

The most recent actuarial valuation of CalPERS indicated that there was an excess of assets over accrued liabilities for benefits due to active and inactive employees and retirees in the plan. The amount of the over funded liability applicable to each agency or department cannot be determined. Trend information, which presents CalPERS progress in accumulating sufficient assets to pay benefits when due is presented in the June 30, 2003 CalPERS CAFR.

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EXHIBIT 2

CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA

Contracts of Purchase

Set forth below is certain financial information regarding Contracts of Purchase.

Existing Contracts of Purchase

The following charts describe the current loan to value ratios and geographic distribution of Contracts of Purchase financed under the Program as of December 31, 2004 using proceeds of Veterans G.O. Bonds, Revenue Bonds and other amounts under the 1943 Fund.

Current Loan-to-Value Ratio of Contracts of Purchase[(1)(2)]

	Uninsured	Radian Insured[(5)]	Radian Insured[(6)]	VA Guaranteed	Total
Single Family Homes					
Less than 30% LTV	$ 88,571	$ 555	$ 168	$ 177	$ 89,472
30-49% LTV	150,371	2,729	389	835	154,325
50-59% LTV	105,730	4,428	476	396	111,030
60-69% LTV	115,318	12,974	930	1,488	130,709
70-79% LTV	185,968	75,987	5,572	5,110	272,637
Sub-total	$ 645,958	$ 96,673	$ 7,535	$ 8,007	$ 758,172
80-84% LTV	$ 11,854	$ 64,995	$ 27,202	$ 10,388	$ 114,439
85-89% LTV	8,050	34,531	75,022	27,444	145,047
90-94% LTV	8,710	30,891	211,187	69,225	320,014
95-97% LTV	6,080	165	84,227	18,640	109,113
Sub-total	$ 34,694	$ 130,582	$ 397,638	$ 125,698	$ 688,613
Greater than 97% LTV	$ 2,136	$ 288	$ 3,158	$ 36,286	$ 41,868
Other Property Types					
Farms	$ 3,977	$ 186	$ 577	$ -	$ 4,741
Mobile Homes in Parks	5,650	-	3,659	-	9,310
Homes under Construction	18,446	57	3,668	-	22,171
Sub-total	$ 28,073	$ 244	$ 7,905	$ -	$ 36,222
Special Status					
Contracts of Purchase					
Real Estate Owned[(3)]	$ 1,050	$ 242	$ 728	$ -	$ 2,020
Disability Program[(4)]	11,328	866	-	-	12,193
Sub-total	$ 12,377	$ 1,108	$ 728	$ -	$ 14,213
Total Portfolio	$ 723,239	$ 228,896	$ 416,964	$ 169,990	$ 1,539,089

(1) 000's omitted
(2) LTV based on current Contracts of Purchase balance divided by original appraised value of the property, except that the Department updates the appraised value of the home when the veteran applies for a home improvement loan. In such cases, the LTV is calculated with the new appraised value.
(3) Repossessed properties and delinquent Contracts of Purchase carried as REO on financial statements.
(4) Contracts of Purchase where payments are made on behalf of veterans by the Department's life and disability coverage plan.
(5) The policy was executed on February 28, 1998.
(6) The policy was executed on July 1, 2000.

Geographic Distribution of Contracts of Purchase

County	Approximate Current Contract Balance
Sacramento	$ 144,786,412
Riverside	142,161,618
San Diego	123,522,105
San Bernardino	116,156,747
Los Angeles	108,866,369
Fresno	88,125,939
Kern	88,068,919
Shasta	51,957,313
San Joaquin	44,421,746
Placer	43,585,645
Solano	42,989,211
Orange	36,474,409
Contra Costa	26,095,549
Other Northern California Counties	260,379,926
Other Central California Counties	181,521,040
Other Southern California Counties	39,975,721
Statewide—California	$ 1,539,088,669

Contracts of Purchase Origination and Principal Repayment Experience

The following tables represent, respectively, a historical picture of Contract of Purchase originations since the 1985 fiscal year and selected principal repayments with respect to Contracts of Purchase since the 1985 fiscal year.

New Contracts of Purchase During the Fiscal Year[1]

Fiscal Year Ending June 30	Veterans G.O. Bonds		Unrestricted Funds		Revenue Bonds		Total	
	Number	Amount	Number	Amount	Number	Amount	Number	Amount
1985	4,196	$ 290,885,900			2,301	$ 154,244,600	6,497	$ 445,130,500
1986	3,484	243,955,800			2,401	160,782,200	5,885	404,738,000
1987	1,569	108,789,700			1,160	75,836,800	2,729	184,626,500
1988	2,958	236,054,500			1,397	99,040,900	4,355	335,095,400
1989	3,112	252,796,300			1,154	83,076,100	4,266	335,872,400
1990	2,097	187,445,600			522	38,150,800	2,619	225,596,400
1991	1,927	200,393,500			359	29,189,600	2,286	229,583,100
1992	1,086	111,600,500			388	34,671,600	1,474	146,272,100
1993	740	94,417,100			286	27,443,800	1,026	121,860,900
1994	843	117,213,779			337	34,740,536	1,180	151,954,315
1995	2,109	286,178,376			822	84,860,894	2,931	371,039,270
1996	762	107,751,444			222	22,723,617	984	130,475,061
1997	766	118,344,636			201	21,853,933	967	140,198,569
1998	615	99,224,002	188	$17,716,376	164	18,871,066	967	135,811,444
1999	758	129,521,359	575	92,728,280	274	33,284,343	1,607	255,533,982
2000	1,045	185,180,534	1,725	333,328,690	708	92,214,409	3,478	610,723,633
2001	844	135,498,480	1,211	232,445,146	697	101,175,512	2,752	469,119,138
2002	334	57,109,103	416	74,798,670	204	27,178,525	954	158,981,879
2003	357	68,105,508	508	99,179,927	123	16,285,625	988	183,496,397
2004	444	97,223,818	1173	274,187,085	165	26,109,792	1782	397,520,696
2005[2]	191	42,087,836	458	107,871,805	161	29,826,135	810	179,785,776

(1) Number of new Contracts of Purchase does not include home improvement loans.
(2) 6-month period through December 31, 2004.

Selected Principal Flows with respect to Contracts of Purchase
Funded by Veterans G.O. Bonds or Revenue Bonds

Fiscal Year Ending June 30	Contracts Funded During Year (000s)	Contract Prepayments During Year (000s)	Other Principal Receipts-Losses During Year (000s)	Contract Balance at End of Year (000s)	Average Rate on all Outstanding Contracts	Average of Monthly FHLMC 30-year Conventional Loan Rate	Annual Average Prepayment Rate	Annual Average Origination Rate
	Principal Flows				Rates			
1985	$ 445,131	$ 123,669	$ 88,308	$ 3,142,526	8.0%	13.8%	4.1%	14.7%
1986	404,738	179,809	94,970	3,272,485	8.0	11.5	5.6	12.6
1987	184,627	261,675	99,569	3,095,868	7.7	9.8	8.2	5.8
1988	335,095	198,396	114,178	3,118,389	7.0	10.5	6.4	10.8
1989	335,872	207,471	105,896	3,140,894	7.3	10.6	6.6	10.7
1990	225,596	232,085	96,639	3,037,766	8.0	10.1	7.5	7.3
1991	229,583	191,895	92,722	2,982,732	8.0	9.9	6.4	7.6
1992	146,272	246,150	92,975	2,789,879	8.0	9.0	8.5	5.1
1993	121,861	273,817	105,629	2,532,294	8.0	8.0	10.3	4.6
1994	151,954	359,749	98,773	2,225,726	8.0	7.3	15.1	6.4
1995	371,039	111,984	74,706	2,410,075	7.8	8.7	4.8	16.0
1996	130,475	141,767	92,521	2,306,262	8.0	7.5	6.0	5.5
1997	140,199	111,254	106,027	2,229,180	8.0	7.9	4.9	6.2
1998	135,811	172,134	94,106	2,098,752	7.7	7.2	8.0	6.3
1999	255,534	183,776	101,254	2,069,256	6.9	6.9	8.8	12.3
2000	610,724	138,401	106,522	2,435,056	6.8	8.1	6.1	27.1
2001	469,119	189,902	91,033	2,623,241	6.8	7.5	7.5	18.5
2002	158,982	330,068	86,556	2,365,599	6.8	6.9	13.2	6.4
2003	183,496	701,785	74,643	1,772,667	6.7	5.9	33.9	8.9
2004	397,521	576,907	53,833	1,539,448	6.4	5.9	34.8	24.0
2005[2]	179,786	150,854	29,291	1,539,089	6.0	5.8	19.6	23.4
	$ 5,613,416	$ 5,083,548	$ 1,900,151					

Reservation rates on new Contracts of Purchase for period:

Period	Veterans G.O. Bonds[1]	Unrestricted Funds	Revenue Bonds
Prior to January 1, 1999, substantially all newly originated Contracts have the same rate as the then outstanding Contracts.			
January 1, 1999 thru June 30, 2000	6.65%	6.65%	5.95%
July 1, 2000 thru February 28, 2001	7.50%	7.95%	6.95%
March 1, 2001 thru May 31, 2001	6.50%	7.95%	6.40%
June 1, 2001 thru August 31, 2001	6.50%	7.10%	6.40%
September 1, 2001 thru April 1, 2002	6.25%	6.50%	6.00%
April 2, 2002 thru July 31, 2002	5.90%	5.50%	5.80%
August 1, 2002 thru December 1, 2002	5.50%	6.00%	5.80%
December 2, 2002 thru June 15, 2003	4.99%	5.40%	5.25%
June 16, 2003 thru September 1, 2003	4.25%	4.50%	4.50%
September 1, 2003 thru September 15, 2003	4.25%	4.99%	4.50%
September 16, 2003 thru May 5,2004	4.50%	4.99%	4.50%
May 6, 2004 thru June 1, 2004	4.75%	5.25%	4.75%
June 2, 2004 thru December 13, 2004	4.95%	5.50%	5.10%
December 14, 2004 thru April 3, 2005	4.95%	5.50%	5.50%
April 4, 2005 forward	5.15%	5.50%	5.50%

(1) Rates for Contracts of Purchase for mobile home in parks shall be 1% higher than the applicable established rates.

(2) 6-month period through December 31, 2004.

Amounts Expected to be Available to Fund Contracts of Purchase and Related Investments

The following table shows amounts expected to be available to fund Contracts of Purchase from Veterans G.O. Bonds and Revenue Bonds. Additional moneys may become available to finance Contracts of Purchase through the future issuances of Veterans G.O. Bonds and Revenue Bonds. The Department has full discretion to use moneys available from prior, current or future bond issues in any order of priority it chooses. As of December 31, 2004, the Department had 353 pending applications for Contracts of Purchase in the aggregate amount of approximately $74,509,000.

			Respective Series Bond Proceeds Subaccounts				
Bond Series	Deposit as of	Balance as of	Unrestricted Moneys[1]	Qualified Veterans Mortgage Bond Proceeds[1]	Qualified Mortgage Bond Proceeds[1]	Investment	Investment Rate (%)
Veterans G.O. Bond Recycling Subaccounts							
Unrestricted		12/31/04	$ 81,238	-0-	-0-	SMIF[2]	Variable
Unrestricted	4/28/05		$ 120,000 [8]	-0-	-0-	SMIF[2]	Variable
QVMB Reimbursement		12/31/04	$ 8,580 [6]	-0-	-0-	SMIF[2]	Variable
QMB Reimbursement		12/31/04	$ 12,920 [7]	-0-	-0-	SMIF[2]	Variable
Other G.O. Series		12/31/04	$ 725	$ 1,780		SMIF[2]	Variable
Total Veterans G.O. Bonds			**$ 223,463**	**$ 1,780**	**-0-**		
Revenue Bonds							
Recycling Subaccounts							
1991 A Recycling		12/31/04	$ 12,710	-0-	-0-	BLB[3]	6.060
1999 A/B		12/31/04	$ 670	-0-	-0-	BLB[4]	5.300
2000 A/B/C		12/31/04	$ 951	-0-	-0-	WestLB[5]	6.460
2001 A		12/31/04	$ 6,800	-0-	-0-	BLB[9]	5.670
2003 A		12/31/04	$ 1,000	-0-	-0-	SMIF[2]	Variable
Total Revenue Bonds			**$ 22,131**	**-0-**	**-0-**		
Grand Total			**$ 245,594**	**$ 1,780**	**$ -0-**		

(1) 000's omitted.
(2) Surplus Money Investment Fund. Amounts invested in SMIF may be withdrawn and reinvested at any time.
(3) Investment agreement maturing December 1, 2009 with Bayerische Landesbank Girozentrale.
(4) Investment agreement maturing December 1, 2028 with Bayerische Landesbank Girozentrale.
(5) Investment agreement maturing June 1, 2010 with Westdeutsche Landesbank Girozentrale. S&P has announced a negative ratings outlook for this bank.
(6) These funds are currently being utilized to fund contracts in anticipation of reimbursement by proceeds of future issuance of Qualified Veterans Mortgage Bonds.
(7) These funds are currently being utilized to fund contracts in anticipation of reimbursement by proceeds of future issuance of Qualified Mortgage Bonds.
(8) Reimbursement proceeds of the Offered Veterans G.O. Bonds.
(9) Investment agreement maturing December 1, 2011 with Bayerische Landesbank Girozentrale.

Cancellations and Delinquencies

Set forth in the table below is a comparative chart of delinquent, cancelled and repossessed Contracts of Purchase and certain comparative information regarding USDVA guaranteed loans during the same period.

	1997[1]	1998[1]	1999[1]	2000[2]	2001[2]	2002[2]	2003[2]	2004[2]	2005[3]
Percentage of Number of Contracts of Purchase Delinquent									
30-60 days[6]	--[8]	--[8]	--[8]	3.91%[7]	4.24%[7]	3.52%[7]	3.13%[7]	2.97%[7]	3.18%[7]
60+ days[6]	--[8]	--[8]	--[8]	2.88%[7]	3.16%[7]	2.43%[7]	2.03%[7]	1.43%[7]	1.48%[7]
Cancelled Contracts and Real Estate in inventory[4]	--[8]	--[8]	--[8]	0.72%[7]	0.69%[7]	0.41%[7]	0.32%[7]	0.22%[7]	0.12%[7]
USDVA Guaranteed Loans[5]									
Percentages in U.S.									
Delinquent									
30-60 days	4.54%	4.45%	4.35%	4.19%	4.71%	4.87%	4.83%	4.53%	4.49%
60+ days	2.21%	2.35%	2.26%	2.25%	2.65%	2.85%	3.15%	2.90%	3.10%
Foreclosures in inventory	1.81%	1.77%	1.82%	1.44%	1.20%	1.72%	1.49%	1.45%	1.50%
Percentages in California									
Delinquent									
30-60 days	4.30%	4.28%	4.13%	4.05%	4.57%	4.57%	4.67%	4.09%	3.52%
60+ days	2.52%	2.61%	2.45%	2.27%	2.49%	2.57%	2.79%	2.34%	2.11%
Foreclosures in inventory	3.54%	2.92%	2.28%	1.39%	0.93%	1.12%	0.93%	0.69%	0.60%

(1) As of June 18 for Department's and as of June 30 for USDVA data.
(2) As of June 30 for Department's and USDVA data.
(3) As of December 31, 2004 for Department's and USDVA data.
(4) Bankruptcies are included in cancelled Contracts statistics and do not exceed in any period more than 10% of total cancellations and bankruptcy category. Federal bankruptcy law precludes repossession action on Contracts of Purchase when veteran is in bankruptcy proceedings until the automatic stay is lifted.
(5) Source: National Delinquency Survey published by the Mortgage Bankers Association of America.
(6) As of the June 30, 1999 installation of the Integrated Loan Processing and Financial Information System, the Department reports delinquencies on a basis consistent with industry standards.
(7) The Department has adjusted the criteria used to identify delinquent contracts from $25 or more delinquent to over $3 delinquent. The data below represents the breakout of delinquent, repayment/forbearance agreements and cancelled Contracts and real estate in inventory. These figures include Contracts that were the subject of forbearance or repayment agreements between the Department and the contract holder.

	2000[2]	2001[2]	2002[2]	2003[2]	2004[2]	2005[3]
Percentage of Number of Contracts of Purchase Delinquent, Repayment/Forbearance Agreements, and Cancelled Contracts and Real Estate in inventory						
30-60 days (Delinquent)	3.78%	3.98%	2.95%	2.77%	2.72%	2.96%
30-60 days (Repayment/Forbearance Agreement)	0.13%	0.26%	0.57%	0.36%	0.25%	0.22%
Total	3.91%	4.24%	3.52%	3.13%	2.97%	3.18%
60+ days (Delinquent)	2.50%	2.29%	1.38%	1.32%	1.08%	1.17%
60+ days (Repayment/Forbearance Agreement)	0.38%	0.87%	1.05%	0.71%	0.35%	0.31%
Total	2.88%	3.16%	2.43%	2.03%	1.43%	1.48%
Cancelled Contracts and Real Estate in inventory	0.72%	0.63%	0.39%	0.31%	0.19%	0.12%
"Repayment/Forbearance Agreement"	-	0.06%	0.02%	0.01%	0.03%	0.00%
Total	0.72%	0.69%	0.41%	0.32%	0.22%	0.12%

(8) The data below represents the Department's reporting method prior to the implementation of the Integrated Loan Processing and Financial Information System. The Department's prior reporting system did not treat contracts that were the subject of forbearance or repayment agreements between the Department and the contract holder as delinquent. As a result, Contracts that were the subject of forbearance or repayment agreements are not included in the 40-68+ days delinquent category, but were included in the cancelled Contracts category.

	1996[1]	1997[1]	1998[1]	1999[1]
Percentage of Number of Contracts of Purchase Delinquent[7]				
40-67 days	2.90%	1.65%	0.78%	0.87%
68+ days	2.50%	3.22%	1.99%	1.34%
Cancelled Contracts and Real Estate in inventory[4]	1.89%	1.86%	1.49%	0.94%

Veterans G.O. Bonds and Revenue Bonds

The chart below sets forth certain information regarding Veterans G.O. Bonds and Revenue Bonds and assumes the issuance of the 2005 Revenue Bonds and the Offered Veterans G.O. Bonds (the "Spring 2005 Transactions.")

Selected Information with Respect to Veterans G.O. Bonds and Revenue Bonds

Series	Bonds Outstanding as of 12/31/04	Expected Bonds Outstanding as of 6/1/05	Final Maturity Date of Series	Next Optional Call Date	Call Price on Such Date	Maximum Coupon Subject to Optional Call	Bonds Subject to Special Redemption[6]
Veterans G.O. Bonds Issued as Qualified Veterans Mortgage Bonds under the 1954 Code							
AK	4,500,000	$ 3,000,000	April 1, 2007	Non-callable	N.A.	N.A.	No
AL	12,000,000	8,000,000	April 1, 2007	Non-callable	N.A.	N.A.	No
AM	20,000,000	20,000,000	October 1, 2008	Non-callable	N.A.	N.A.	No
AN/AP	52,500,000	42,000,000	April 1, 2009	Non-callable	N.A.	N.A.	No
AQ	42,000,000	42,000,000	October 1, 2008	Non-callable	N.A.	N.A.	No
AR	22,000,000	22,000,000	October 1, 2009	Non-callable	N.A.	N.A.	No
AS	29,000,000	29,000,000	October 1, 2009	Non-callable	N.A.	N.A.	No
AT	117,985,000	100,715,000	February 1, 2010	Non-callable	N.A.	N.A.	No
AU	72,930,000	72,930,000	October 1, 2010	Non-callable	N.A.	N.A.	No
AV	49,780,000	49,780,000	October 1, 2010	Non-callable	N.A.	N.A.	No
Sub-total	$ 422,695,000	$ 389,425,000					
Veterans G.O. Bonds Issued as Qualified Veterans Mortgage Bonds under the 1986 Code							
BC/BF[1]	$ 1,200,000	$ 100,000	February 1, 2006	[3]	100%	5.65%	Allocated Prepayments[2]
BG/BH[8]	462,195,000	363,880,000 [8]	December 1, 2032	--[4]	--[4]	5.600%[4]	Excess Revenues
BJ7	2,895,000	2,895,000	December 1, 2012	December 1, 2009	101%	5.625%	Excess Revenues
BJ9	6,520,000	6,520,000	December 1, 2016	April 27, 2010	101%	5.600%	Excess Revenues
BK	100,000	100,000	December 1, 2005	--[4]	--[4]	N/A	Excess Revenues
BP	8,290,000	5,130,000 [8]	December 1, 2026	Anytime	100%	5.500%	Excess Revenues
BQ/BR	48,730,000	48,730,000	December 1, 2029	June 1, 2005	100%	5.300%	Excess Revenues
BS	1,000,000	1,000,000	December 1, 2008	Non-callable	N/A	N/A	Excess Revenues
BJ11/12[5]	56,370,000	56,370,000	December 1, 2032	--[5]	--[5]	5.700%	Excess Revenues
BT/BU	76,630,000	76,630,000	December 1, 2026	December 1, 2005	101%	5.650%	Excess Revenues
BV/BW	30,735,000	30,735,000	December 1, 2032	June 1, 2006	101%	5.600%	Excess Revenues
BX	42,000,000	42,000,000	December 1, 2032	June 1, 2006	101%	5.500%	Excess Revenues
BY/BZ	111,325,000	111,325,000	December 1, 2024	June 1, 2007	101%	5.375%	Excess Revenues
CA/CB[7]	--	221,475,000	December 1, 2036	June 1, 2015	100%	5.050%	Excess Revenues
Sub-total	$ 847,990,000	$ 996,890,000					
TOTAL VETERANS G.O. BONDS	$ 1,270,685,000	$ 1,356,315,000					

Series	Bonds Outstanding as of 12/31/04	Expected Bonds Outstanding as of 6/1/05	Final Maturity Date of Series	Next Optional Call Date	Call Price on Such Date	Maximum Coupon Subject to Optional Call	Bonds Subject to Special Redemption[6]
Revenue Bonds Issued as Qualified Mortgage Bonds under the 1986 Code							
1997 A/B	$ 18,925,000	$ 18,925,000	December 1, 2028	December 1, 2008	101%	5.500%	Excess Revenues
1997 C	54,855,000	54,855,000	December 1, 2019	January 9, 2011	101%	5.500%	Excess Revenues
1998 A	37,535,000	37,535,000	December 1, 2019	December 1, 2008	101%	5.450%	Excess Revenues
Sub-total	$ 111,315,000	$ 111,315,000					
Revenue Bonds Issued to Refund Bonds Issued Prior to Mortgage Subsidy Bond Tax Act of 1980							
1999 A	$ 54,170,000	$ 54,170,000	December 1, 2027	June 1, 2005	100%	5.200%	Excess Revenues
1999 B	86,085,000	86,086,000	December 1, 2028	June 1, 2005	100%	5.200%	Excess Revenues
2000 C[9]	42,600,000	--[9]	December 1, 2027	June 1, 2005	101%	6.150%	Excess Revenues
2001 A	39,840,000	39,840,000	December 1, 2028	June 1, 2006	101%	5.600%	Excess Revenues /Unexpended
2002 A	117,200,000	117,200,000	December 1, 2027	June 1, 2012	101%	5.350%	Excess Revenues /Unexpended
2003 A	124,635,000	84,635,000[9]	December 1, 2028	Anytime	100%	Variable	Excess Revenues
2005 A	--	42,600,000	December 1, 2027	June 1, 2015	100%	4.80%	Excess Revenues
Sub-total	$ 464,530,000	$ 464,530,000					
TOTAL REVENUE BONDS	$ 575,845,000	$ 575,845,000					
TOTAL ALL BONDS	$1,846,530,000	$ 1,932,160,000					

(1) Series BC/BF includes Series BC, Series BD, Series BE and Series BF.

(2) Subject to redemption at par from a portion of prepayments on all Contracts of Purchase as allocated to Series based on periodically determined ratio of outstanding bonds (including Veterans G.O. Bonds and Revenue Bonds) of Series to all outstanding bonds. Series BC/BF is now subject to optional redemption at par.

(3) The Series BC/BF Bonds are subject to optional redemption prior to their respective stated maturity dates, in whole on the first day of any month, or in part on any interest payment date.

(4) Except as described in the next sentence, the Series BG Bonds and Series BH Bonds are subject to optional redemption on and after December 1, 2008, initially at 101% of the principal amount thereof, declining to par on December 1, 2009. The Series BH Bonds maturing on December 1, 2018, December 1, 2024, and December 1, 2032 are currently subject to optional redemption at 101% of the principal amount thereof, declining to redemption at par on or after December 1, 2005. The Series BK Bonds are not subject to optional redemption.

(5) The BJ-11/12 Serial Bonds maturing on December 1, 2011 through and including December 1, 2016 are subject to optional redemption on December 19, 2010, initially at 101% of the principal amount thereof, declining to par on and after December 19, 2011. The BJ-11/12 Term Bonds maturing on December 1, 2032 are subject to optional redemption on December 19, 2006, initially at 102% of the principal amount thereof, declining to par on and after December 19, 2008.

(6) Excess Revenues includes principal prepayments.

(7) Veterans G.O. Bonds that are part of the Spring 2005 Transactions.

(8) Reflects partial redemption by the expected issuance of the Offered Veterans G.O. Bonds as part of the Spring 2005 Transactions.

(9) Reflects full or partial redemption by the expected issuance of the 2005 Revenue Bonds as part of the Spring 2005 Transactions.

Additional Investments

In addition to the investments described above under "CONTRACTS OF PURCHASE--Amounts Expected to be Available to Fund Contracts of Purchase and Related Investments," the following investments have been made or will be made with respect to moneys in the 1943 Fund and in the Bond Reserve Account which secures the Revenue Bonds. Additional moneys in various Funds and Accounts in the 1943 Fund have been invested in SMIF. Amounts invested in SMIF may be withdrawn and reinvested at any time.

Bond Series	Account Designation[1]	Amount (000s)	Investment Provider[1]	Initial Investment Date	Investment Maturity Date	Interest Rate (%)
1997/1998	Reserve	$5,251[13]	Societe Generale	3/26/98	12/1/28	5.75
1997/1998	Reserve	$6,513[2,13]	U.S. Treasury	5/8/98	5/15/05	6.50
1999 A/B	Reserve	$9,817[13]	Westdeutsche Landesbank Girozentrale[7]	3/30/99	12/1/28	5.38
2000 A/B/C	Reserve	$2,715[13]	Trinity Plus Funding Company, LLC	4/1/00	12/1/27	6.895
1997 C	Reserve	$5,733[13]	Westdeutsche Landesbank Girozentrale[7]	1/1/01	12/1/19	5.625
2002 A	Reserve	$3,759[13]	Bayerische Landesbank Girozentrale	3/6/02	12/1/27	5.38
BG/BH/BK /BL	Revenue/ Recycling	variable [3]	Societe Generale	12/29/97	12/1/32	5.91
1997/1998	Revenue/ Restricted Recoveries	variable	Societe Generale	3/26/98	12/1/28	5.91
BP/BN-1	Revenue/ Recycling	variable [4]	Westdeutsche Landesbank Girozentrale[7]	5/5/98	12/1/28	5.38
BQ/BR	Revenue/ Recycling	variable [5]	Westdeutsche Landesbank Girozentrale[7]	4/28/99	12/1/29	5.37

Bond Series	Account Designation[1]	Amount (000s)	Investment Provider[1]	Initial Investment Date	Investment Maturity Date	Interest Rate (%)
BJ 7/8	Revenue/ Recycling	variable[6]	Bayerische Landesbank Girozentrale	12/1/99	12/1/32[6]	6.06
BJ 9/10	Revenue/ Recycling	variable[8]	Westdeutsche Landesbank Girozentrale[7]	4/27/00	12/1/32[8]	
BS	Revenue	variable[8]	Westdeutsche Landesbank Girozentrale[7]	4/27/00	12/1/32[8]	
BJ 11/12	Revenue/ Recycling	variable[9]	Westdeutsche Landesbank Girozentrale[7]	12/19/00	12/1/32[9]	6.46
BT/BU	Revenue/ Recycling	variable[10]	Westdeutsche Landesbank Girozentrale[7]	12/19/00	12/1/26[10]	6.46
1997 C	Revenue/ Restricted Recoveries	variable[11]	Westdeutsche Landesbank Girozentrale[7]	1/9/01	12/1/19	5.50
BV/BW	Revenue/ Recycling	variable[12]	Bayerische Landesbank Girozentrale	6/20/01	12/1/32[12]	5.50
BX	Revenue/ Recycling	variable[12]	Bayerische Landesbank Girozentrale	6/20/01	12/1/32[12]	5.50

Footnotes are on the following page.

(1) Accounts are established in the resolutions authorizing the issuance of Revenue Bonds. All investments are investment agreements unless otherwise noted.

(2) At cost. Invested in U.S. Treasury Bonds.

(3) Maximum permitted amount on deposit under investment agreement at any one time is $250,000,000.

(4) Maximum permitted amount on deposit under investment agreement for all (BN-1 and BP) subaccounts is $50,000,000.

(5) Maximum permitted amount on deposit under investment agreement for both subaccounts is $35,000,000.

(6) Maximum permitted amount on deposit under investment agreement for all BJ 7/8 and 1991 A subaccounts is $25,000,000. Investment maturity date for the recycling subaccounts is December 1, 2009.

(7) S&P has announced a negative ratings outlook for this bank.

(8) Maximum permitted amount on deposit under investment agreement for all three (BJ 9/10 and BS) subaccounts is $20,000,000. Investment maturity date for BJ-9/10 G.O. Bond Series Recycling Subaccount is June 1, 2010.

(9) Maximum permitted amount on deposit under investment agreement for both subaccounts is $25,000,000. Investment maturity date for BJ-11/12 G.O. Bond Series Recycling Subaccount is December 1, 2010.

(10) Maximum permitted amount on deposit under investment agreement for both subaccounts is $20,000,000. Investment maturity date for BT/BU G.O. Bond Series Recycling Subaccount is December 1, 2010.

(11) Maximum permitted amount on deposit under investment agreement for both subaccounts is $97,130,000.

(12) Maximum permitted amount on deposit under investment agreement for all (BV/BW, 2001 A, BX) subaccounts is $25,000,000. Investment maturity date for all (BV/BW, 2001 A, BX) recycling subaccounts is December 1, 2011.

(13) As of December 31, 2004.

EXHIBIT 3

UNAUDITED FINANCIAL STATEMENTS OF THE 1943 FUND FOR THE PERIOD ENDED DECEMBER 31, 2004*

Condensed Financial Information:

(In thousands of dollars)

Balance Sheets

Condensed Balance Sheet	Dec-04	Dec-03	% Change
Assets			
Cash and investments	$ 544,364	$1,121,235	-51.45%
Receivables under contracts of sale-net	1,527,857	1,561,044	-2.13%
Other receivables and assets	55,259	60,458	-8.60%
Total	$ 2,127,480	$2,742,737	-22.43%
Liabilities			
Bonds payable	1,836,465	2,425,519	-24.29%
Other payables and liabilities	51,234	57,523	-10.93%
Total	1,887,699	2,483,042	-23.98%
Fund Equity	239,781	259,695	-7.67%
Total	$ 2,127,480	$2,742,737	-22.43%

*Un-Audited Financial Statements have been prepared according to applicable GASB rules. Footnotes to the financials and GASB 34 adjustments are only updated once annually at the end of each fiscal year.

Total assets decreased $615 million from $2.74 billion at December 31, 2003 to $2.13 billion at December 31, 2004. This decrease consisted primarily of the following items:

Total cash and investments decreased by $577 million from $1.1 billion at December 31, 2003 to $544 million at December 31, 2004.

Net receivables under contracts of sale decreased $33 million from $1.56 billion at December 31, 2003 to $1.53 billion at December 31, 2004. December 2004, $24.4 million in new loans were originated, payoffs totaled $26.3 million and monthly principal payments totaled $5.6 million for a net decrease in the portfolio of $7.5 million.

All other assets decreased by $5.2 million from $60.4 million as of December 31, 2003 to $55.2 million at December 31, 2004. Accrued interest for loans has decreased $451 thousand due to the decrease in the loan portfolio, a decrease of $1.7 million in interest receivable for guaranteed investment agreements/SMIF, a decrease in REO of $2.1 million due to a decrease in repossessions and increased sales of properties, depreciation decreased fixed assets by approximately $800 thousand and the Due from Debenture Advances from

Farm & Home account decreased $1.5 million. There were increases of $457 thousand in Accounts Receivable and $881 thousand in Prepaid accounts.

Total liabilities decreased $595 million from $2.5 billion at December 31, 2003 to $1.9 billion in December of 2004. This decrease is the result of the retiring $594 million of bonds through maturities or early redemptions; the costs of issuance/premiums were expensed at the time of redemption and accrued interest & other liabilities decreased due to debt service and a reduction in interest payable for the bonds.

Fund equity decreased by $19.9 million from $259.6 million December 31, 2003 to $239.7 million December 31, 2004 as a result of the excess of expenses over revenues of $20 million. The loss December, 2004 was $754 thousand compared to a loss of $3.6 million December, 2003.

VETERANS FARM AND HOME BUILDING FUND OF 1943,

DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA

BALANCE SHEETS

DECEMBER 31, 2004 AND 2003

	2004	2003	Change
ASSETS			
Current assets:			
Cash and cash equivalents:			
Cash In State Treasury	$11,944,674	$7,475,220	$4,469,454
State of California's Surplus Money Investment Fund	369,234,000	826,317,000	(457,083,000)
Total cash and cash equivalents	381,178,674	833,792,220	(452,613,546)
Receivables under contracts of sale, net of allowance for uncollectible contracts of $8,540 in 2004 and $10,040 in 2003	1,527,857,538	1,561,043,509	(33,185,971)
Interest Receivable:			
Contracts of sale	7,954,978	8,405,902	(450,924)
State of California's Surplus Money Investment Fund	2,033,295	2,966,768	(933,473)
Other investments	802,156	1,606,585	(804,429)
Total current assets	1,919,826,641	2,407,814,983	(487,988,342)
Noncurrent assets:			
Investments:			
Guaranteed investment contracts	157,135,840	285,593,369	(128,457,529)
Insurance administrators	6,050,000	1,850,000	4,200,000
Total investments	163,185,840	287,443,369	(124,257,529)
Due from Veterans Debenture Revenue Fund	37,567,500	39,067,500	(1,500,000)
Other real estate owned, net of allowance for losses of $527 in 2004 and $1,020 in 2003	2,299,061	4,369,495	(2,070,434)
Land, improvements and equipment, net of accumulated depreciation of $13,163 in 2004 and $12,362 in 2003	2,947,773	3,741,739	(793,966)
Other	1,653,228	300,005	1,353,223
Total noncurrent assets	207,653,403	334,922,109	(127,268,706)
Total assets	$2,127,480,044	$2,742,737,092	($615,257,048)

LIABILITIES AND FUND EQUITY			
Current liabilities:			
Bonds payable - current portion	$34,370,000	$30,560,000	$3,810,000
Accrued interest and other liabilities	30,416,845	34,426,129	(4,009,284)
Due to other funds	1,327,868	972,958	354,910
Total current liabilities	66,114,713	65,959,086	155,626
Noncurrent liabilities:			
Bonds payable - noncurrent portion	1,802,094,196	2,394,958,743	(592,864,547)
Insurance claims payable and loss reserves	19,490,600	22,123,807	(2,633,207)
Total noncurrent liabilities	1,821,584,796	2,417,082,549	(595,497,753)
Total liabilities	1,887,699,509	2,483,041,636	(595,342,127)
Fund equity:			
Retained Earnings	249,367,170	277,931,118	(28,563,948)
Gain/(Loss)	(9,586,635)	(18,235,662)	8,649,027
Total fund equity	239,780,535	259,695,456	(19,914,921)
Total liabilities and fund equity	$2,127,480,044	$2,742,737,092	($615,257,048)

Condensed Financial Information:

(In thousands of dollars)

Revenues, Expenses and Changes in Fund Equity

Condensed Statements of Revenues, Expenses and Changes in Fund Equity

	July - Dec 2004	July - Dec 2003	% Change
PROGRAM OPERATIONS:			
Interest revenues:			
Contracts of Sale	$ 46,509	$ 52,551	-11.50%
Investments and other	9,787	15,848	-38.24%
	56,296	68,399	-17.69%
Expenses:			
Interest expense	57,245	76,504	-25.17%
Other Expenses	-	-	-
Total program operating expenses	57,245	76,504	-25.17%
Excess of program operations revenue over program operations expense	(949)	(8,105)	-88.29%
PROGRAM ADMINISTRATION:			
Total program administration revenues	4,119	4,086	0.81%
Total program administration expenses	13,011	15,104	-13.86%
Excess of program administration revenue over program administration expense.	(8,892)	(11,018)	-19.29%
Gain on sale of repossessed property	254	887	-71.36%
Total	$ (9,587)	$ (18,236)	-47.43%

Program Operations

Principally due to the decline of the Program's loan portfolio, the program interest revenues from the Contracts of Sale decreased by $6.0 million from $52.5 million for the period ended December 31, 2003 to $46.5 million for the period ended December 31, 2004.

The interest revenues on investments decreased by $6.0 million from $15.8 million for the period ended December 31, 2003 to $9.8 million for the period ended December 31, 2004. This decrease is due to increased Contracts of Purchase prepayments resulting in a shift of assets from higher yielding contracts of sale to low yielding short term investment accounts. Interest expense decreased $19.2 million for the period due to maturities and the early redemption of bonds.

Program Administration

The revenues for program administration are limited primarily to fees collected from the program participants and the net of amounts charged for the fire and hazard insurance program. The total program administration revenues increased by $33 thousand or from $4.09 million for the period ended December 31, 2003 to $4.12 million for the period ended December 31, 2004.

Program administration expenses consist of payroll and related costs, general and administrative cost and have decreased $2 million for the period.

The loss for the month of December, 2004 was $754 thousand compared to $3.6 million December, 2003. Losses for the month of December were reduced by a transfer in from Debenture Fund of approximately $1 million of interest income received from investments on Debenture's books.

VETERANS FARM AND HOME BUILDING FUND OF 1943,

DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN RETAINED EARNINGS

YEAR TO DATE JULY - DECEMBER 2004 AND 2003

	July - Dec 2004	July - Dec 2003	Change
PROGRAM OPERATIONS:			
Interest revenues:			
Contracts of sale of properties	$46,509,420	$52,550,650	($6,041,230)
Investments and other	8,767,871	14,845,967	(6,078,097)
Transfers of revenue from Veterans Debenture Revenue Fund	1,018,863	1,002,418	16,445
Total program operations revenues	56,296,153	68,399,035	(12,102,882)
Expenses:			
Interest expense	57,245,097	76,503,906	(19,258,809)
Reversal of allowance for uncollectible contracts			-
Total program operations expenses	57,245,097	76,503,906	(19,258,809)
Excess of program operations revenues over program operations expenses	(948,944)	(8,104,871)	7,155,927
PROGRAM ADMINISTRATION:			
Revenues:			
Loan fees	2,599,134	3,632,948	(1,033,814)
Other income	516,733	602,402	(85,669)
Excess of amounts charged to contract holders over fire and hazard insurance claims and expenses and changes in insurance reserves	1,002,921	(148,957)	1,151,878
Total program administration revenues	4,118,788	4,086,393	32,394
Expenses:			
Payroll and related costs	6,417,148	6,882,179	(465,031)
General and administrative expenses	4,842,540	6,091,930	(1,249,390)
Excess of self-insured life and disability insurance claims and expenses and changes in insurance reserves over amounts charged to contract holders	1,750,953	2,130,210	(379,257)
Total program administration expenses	13,010,641	15,104,320	(2,093,678)
Excess of program administration expenses over program administration revenues	(8,891,853)	(11,017,926)	2,126,073
GAIN (LOSS) ON SALE OF REPOSSESSED PROPERTY	254,162	887,136	(632,974)
EXCESS OF REVENUES OVER EXPENSES	(9,586,635)	(18,235,662)	8,649,026
RETAINED EARNINGS:			
Beginning of year	249,367,170	277,931,118	(28,563,948)
End of year	$239,780,535	$259,695,456	($19,914,922)

APPENDIX C
DTC AND THE BOOK-ENTRY SYSTEM

The information in this Appendix concerning The Depository Trust Company ("DTC"), New York, New York, and DTC's book-entry system has been obtained from sources that the State Treasurer believes to be reliable, but the State Treasurer and the Underwriters take no responsibility for the accuracy or completeness thereof.

DTC will act as securities depository for the Offered Veterans G.O. Bonds. The Offered Veterans G.O. Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully registered Offered Veterans G.O. Bond certificate will be issued for each maturity of each Series of the Offered Veterans G.O. Bonds in the aggregate principal amount of such maturity, and will be deposited with DTC.

DTC, the world's largest depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934, as amended. DTC holds and provides asset servicing for over 2 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues and money market instruments from over 85 countries that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Government Securities Clearing Corporation, MBS Clearing Corporation and Emerging Markets Clearing Corporation (NSCC, GSCC, MBSCC and EMCC, also subsidiaries of DTCC), as well as by the New York Stock Exchange, Inc., the American Stock Exchange, LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as securities brokers and dealers, banks, trust companies and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has Standard & Poor's highest rating: AAA. The DTC applicable rules to Direct Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com.

Purchases of the Offered Veterans G.O. Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Offered Veterans G.O. Bonds on DTC's records. The ownership interest of each actual purchaser of each Offered Veterans G.O. Bond ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase, but Beneficial Owners are expected to receive written confirmation providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Offered Veterans G.O. Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in Offered Veterans G.O. Bonds, except in the event that use of the book-entry system for the Offered Veterans G.O. Bonds is discontinued.

To facilitate subsequent transfers, all Offered Veterans G.O. Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of Offered Veterans G.O. Bonds with DTC and their registration in the name of Cede & Co., or such other DTC nominee, do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Offered Veterans G.O. Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Offered Veterans G.O. Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. The State Treasurer will not have any responsibility or obligation to such Direct Participants and Indirect Participants or the persons for whom they act as nominees with respect to the Offered Veterans G.O. Bonds.

Beneficial Owners of the Offered Veterans G.O. Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Offered Veterans G.O. Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Offered Veterans G.O. Bond documents. Beneficial Owners of the Offered Veterans G.O. Bonds may wish to ascertain that the nominee holding the Offered Veterans G.O. Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners.

Redemption notices shall be sent to DTC. If less than all of a maturity of a Series of the Offered Veterans G.O. Bonds is being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such maturity to be redeemed.

Neither DTC nor Cede & Co. (nor such other DTC nominee) will consent or vote with respect to Offered Veterans G.O. Bonds unless authorized by a Direct Participant in accordance with DTC's procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the State Treasurer as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Offered Veterans G.O. Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Without limiting the generality of the foregoing, the State Treasurer and the Underwriters have no responsibility or liability for any aspects of the records relating to or payments made on account of beneficial ownership, or for maintaining, supervising or reviewing any records relating to beneficial ownership, or interests in the Offered Veterans G.O. Bonds.

Principal, premium and interest payments on the Offered Veterans G.O. Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the State Treasurer, on payable dates in accordance with their respective holdings shown on DTC's records. Payments by Direct Participants and Indirect Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name" and will be the responsibility of such Direct or Indirect Participants and not of DTC (nor its nominee) or the State Treasurer, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal and interest to Cede & Co. (or such other nominee and may be requested by an authorized representative of DTC) is the responsibility of the State Treasurer, disbursement of such payments to Direct Participants shall be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners shall be the responsibility of Direct and Indirect Participants.

The State Treasurer and the Underwriters cannot and do not give any assurances that DTC, Direct Participants, Indirect Participants or others will distribute payments with respect to the Offered Veterans G.O. Bonds received by DTC or its nominee as the registered owner, or any prepayment or other notices, to the Beneficial Owners, or that they will do so on a timely basis, or that DTC will serve and act in the manner described in this Official Statement.

If the State Treasurer determines not to continue the DTC book-entry only system, or DTC discontinues providing its services with respect to the Offered Veterans G.O. Bonds and the State Treasurer does not select another qualified security depository, the State shall deliver physical Offered Veterans G.O. Bond certificates to the Beneficial Owners. The Offered Veterans G. O. Bonds may thereafter be transferred upon the books of the State Treasurer by the registered owners, in person or by authorized attorney, upon surrender of Offered Veterans G.O. Bonds at the Office of the State Treasurer in Sacramento, California, accompanied by delivery of an executed instrument of transfer in a form approved by the State Treasurer and upon payment of any charges provided for in the Resolutions. Certificated Offered Veterans G.O. Bonds may be exchanged for Offered Veterans G.O. Bonds of other authorized denominations of the same aggregate principal amount and maturity at the Office of the State Treasurer in Sacramento, California, upon payment of any charges provided for in the Resolutions. No transfer or exchange of Offered Veterans G.O. Bonds shall be made by the State Treasurer during the period between the record date and the next Interest Payment Date.

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APPENDIX D

SUMMARY OF CONTINUING DISCLOSURE CERTIFICATES

STATE TREASURER'S DISCLOSURE CERTIFICATE

The State Treasurer, on behalf of the State, executed a Continuing Disclosure Certificates (the "Treasurer's Disclosure Certificate") for the Offered Veterans G.O. Bonds. The following is a summary of the provisions of the Treasurer's Disclosure Certificate. Such summary is qualified by reference to the complete Treasurer's Disclosure Certificate, which is available from the Office of the State Treasurer.

Definitions

Defined terms used in the Treasurer's Disclosure Certificate and not otherwise defined therein have the meanings set forth elsewhere in this Official Statement:

"Annual Report" shall mean the Annual Report filed by the State Treasurer pursuant to, and as described in, the Treasurer's Disclosure Certificate.

"Beneficial Owner" shall mean any person which has or shares the power, directly or indirectly, to make investment decisions concerning ownership of Offered Veterans G.O. Bonds (including persons holding Offered Veterans G.O. Bonds through nominees, depositories or other intermediaries).

"Central Post Office" means the DisclosureUSA website maintained by the Municipal Advisory Council of Texas or any successor thereto, or any other organization or method approved by the staff or members of the Securities and Exchange Commission (the "SEC") as an intermediary through which issuers may, in compliance with the Rule, make filings required by this Disclosure Certificate.

"Dissemination Agent" shall mean the State Treasurer, acting in its capacity as Dissemination Agent under the Treasurer's Disclosure Certificate, or any successor Dissemination Agent designated in writing by the State Treasurer.

"Holder" shall mean any person listed on the registration books of the State Treasurer as the registered owner of Offered Veterans G.O. Bonds.

"Listed Events" shall mean any of the events listed below under "Reporting of Significant Events."

"National Repository" shall mean any Nationally Recognized Municipal Securities Information Repository certified by the Securities and Exchange Commission to be the recipient of information of the nature of the Annual Reports required by the Treasurer's Disclosure Certificate.

"Official Statement" shall mean the Official Statement relating to the Offered Veterans G.O. Bonds.

"Repository" shall mean each National Repository and the State Repository.

"Rule" shall mean Rule 15c2-12(b)(5) adopted by the Securities and Exchange Commission under the Securities Exchange Act of 1934, as the same may be amended from time to time.

"State" shall mean the State of California.

"State Repository" shall mean any public or private repository or entity within the State created for the purpose of receiving information of the nature of the Annual Reports or reports of material events required by the Treasurer's Disclosure Certificate and recognized as such by the Securities and Exchange Commission. As of the date of this Official Statement, there is no State Repository.

Annual Reports

The State Treasurer on behalf of the State shall, not later than April 1 of each year in which the Offered Veterans G.O. Bonds are outstanding, commencing with the report for the 2004-05 Fiscal Year, provide an Annual Report consistent with the requirements of the Treasurer's Disclosure Certificate (an "Annual Report") to each Repository; provided that the audited financial statements of the State may be submitted separately from the balance of the Annual Report and later than the date required above for the filing of the Annual Report if they are not available by that date. The State Treasurer shall make a copy of any Annual Report available to any person who requests a copy at a cost not exceeding the reasonable cost of duplication and delivery. The State reserves the right to make this filing through the Central Post Office.

If in any year, the State Treasurer does not provide the Annual Report to each Repository by the time specified above, the State Treasurer shall instead file a notice with each Repository stating that the Annual Report has not been timely completed and, if known, stating the date by which the State Treasurer expects to file the Annual Report. Giving of a notice pursuant to this paragraph shall not excuse failure to file the Annual Report pursuant to the paragraph above.

The Annual Report shall contain or include by reference the following:

(1) The audited General Purpose Financial Statements of the State for the fiscal year ended on the previous June 30, prepared in accordance with generally accepted accounting principles promulgated to apply to government entities from time to time by the Governmental Accounting Standards Board. If the State's audited financial statements are not available by the time the Annual Report is required to be filed pursuant to the Treasurer's Disclosure Certificate, the Annual Report shall contain unaudited financial statements in a format similar to the financial statements contained in the applicable final Official Statement, and the audited financial statements shall be filed in the same manner as the Annual Report when they become available.

(2) Financial information relating to the State's General Fund budget for the fiscal year ended on the previous June 30 and information concerning the State budget for the fiscal year in which the Annual Report is issued. Such information shall describe the sources of revenues, the principal categories of expenditures, and changes in fund balances, a summary of expected State revenues and budgeted expenditures, and significant assumptions relating to revenue and expenditure expectations, including updating the following tables which appear under the caption APPENDIX A – "THE STATE OF CALIFORNIA – CURRENT STATE BUDGET AND GOVERNOR'S PROPOSED 2005-06 BUDGET" in the applicable Official Statement:

Tables Entitled

Statement of Revenues, Expenditures and Changes in Fund Balance – General Fund
Major General Fund Revenue Sources and Expenditures

(3) Information concerning the total amount of the State's authorized and outstanding debt, long-term lease obligations and other long-term liabilities as of the end of the most recent June 30, which debt is supported by payments from the State's General Fund and which includes short-term debt. Such information shall include schedules of debt service for outstanding general obligation bonds and lease-purchase debt. This shall be accomplished by updating the following tables which appear under the caption APPENDIX A – "THE STATE OF CALIFORNIA – STATE DEBT TABLES" in the Official Statement.

Tables Entitled

Outstanding State Debt

Authorized and Outstanding General Obligation Bonds

General Obligation and Lease Revenue Bonds – Summary of
Debt Service Requirements

Schedule of Debt Service Requirements for General Fund
Non-Self Liquidating Bonds – Fixed Rate

Schedule of Debt Service Requirements for General Fund
Non-Self Liquidating Bonds – Variable Rate

Schedule of Debt Service Requirements for Enterprise Fund
Self Liquidating Bonds – Fixed Rate

Schedule of Debt Service Requirements for Special Revenue Fund
Self Liquidating Bonds – Fixed Rate

Schedule of Debt Service Requirements for Special Revenue Fund
Self Liquidating Bonds – Variable Rate

Schedule of Debt Service Requirements for Lease-Purchase Debt

State Public Works Board and Other
Lease-Purchase Financing Outstanding Issues

State Agency Revenue Bonds and
Conduit Financing

The Annual Report may consist of one or more documents. Any or all of the items listed above may be included in the Annual Report by reference to other documents which have been filed by the State with each of the Repositories, including any final official statement (in which case such final official statement must also be available from the Municipal Securities Rulemaking Board). The State Treasurer shall clearly identify in the Annual Report each such document so included by reference.

Reporting of Significant Events

The State Treasurer, on behalf of the State shall give, or cause to be given, prompt notice of the occurrence of any of the following events with respect to Offered Veterans G.O. Bonds, if material:

1. principal and interest payment delinquencies;
2. non-payment related defaults;
3. modifications to rights of Bondholders;
4. optional, contingent or unscheduled bond calls;
5. defeasances;
6. rating changes;
7. adverse tax opinions or events affecting the tax-exempt status of Offered Veterans G.O. Bonds;
8. unscheduled draws on debt service reserves reflecting financial difficulties;
9. unscheduled draws on credit enhancements reflecting financial difficulties;
10. substitution of credit or liquidity providers, or their failure to perform; or
11. release, substitution or sale of property securing repayment of Offered Veterans G.O. Bonds.

The State Treasurer shall timely file a notice of the occurrence of a Listed Event, which is material under applicable federal securities laws, with the Municipal Securities Rulemaking Board and each Repository. The State notes that items 8, 9, 10 and 11 above are not applicable to Offered Veterans G.O. Bonds.

The State reserves the right to make such filings through the Central Post Office.

Other Provisions

Termination of Reporting Obligation. The State's obligations under the Treasurer's Disclosure Certificate shall terminate upon the maturity, legal defeasance, prior redemption or acceleration of all of the applicable outstanding Offered Veterans G.O. Bonds. If such termination occurs prior to the final maturity of the Offered Veterans G.O. Bonds, the State Treasurer shall give notice of such termination in the same manner as for a Listed Event.

Dissemination Agent. The State Treasurer may, from time to time, appoint or engage a Dissemination Agent to assist it in carrying out the obligations under the Treasurer's Disclosure Certificate, and may discharge any such Dissemination Agent, with or without appointing a successor Dissemination Agent. The Dissemination Agent shall not be responsible in any manner for the content of any notice or report prepared by the State Treasurer pursuant to Treasurer's Disclosure Certificate. If at any time there is not any other designated Dissemination Agent, the State Treasurer shall be the Dissemination Agent. The initial Dissemination Agent shall be the State Treasurer.

Amendment; Waiver. Notwithstanding any other provision of the Treasurer's Disclosure Certificate, the State Treasurer may amend or waive any provision of the Treasurer's Disclosure Certificate, provided that the following conditions are satisfied:

(a) If the amendment or waiver relates to the provisions of the Treasurer's Disclosure Certificate dealing with the timing or content of the Annual Report or the giving of notice of Listed Events, it may only be made in connection with a change in circumstances that arises from a change in legal requirements, change in law or change in the identity, nature or status of an obligated person with respect to Offered Veterans G.O. Bonds, or the type of business conducted;

(b) The undertaking, as amended or taking into account such waiver, would, in the opinion of nationally recognized bond counsel, have complied with the requirements of the Rule at the time of the issuance of Offered Veterans G.O. Bonds, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and

(c) The amendment or waiver either (i) is approved by the Holders of sixty percent (60%) of Offered Veterans G.O. Bonds, or (ii) does not, in the opinion of nationally recognized bond counsel, materially impair the interests of the Holders or Beneficial Owners of Offered Veterans G.O. Bonds.

Additional Information. Nothing in the Treasurer's Disclosure Certificate shall be deemed to prevent the State Treasurer from disseminating any other information, using the means of dissemination set forth in the Treasurer's Disclosure Certificate or any other means of communication, or including any other information in any Annual Report or notice of occurrence of a Listed Event, in addition to that which is required by the Treasurer's Disclosure Certificate. If the State Treasurer chooses to include any information in any Annual Report or notice of occurrence of a Listed Event in addition to that which is specifically required by the Treasurer's Disclosure Certificate, the State Treasurer shall not have any obligation to update such information or include it in any future Annual Report or notice of occurrence of a Listed Event.

Beneficiaries. The Treasurer's Disclosure Certificate shall inure solely to the benefit of the Holders and Beneficial Owners from time to time of Offered Veterans G.O. Bonds, and shall create no rights in any other person or entity (except the right of any Bondholder or Beneficial Owner to enforce the provisions of the Treasurer's Disclosure Certificate on behalf of the Bondholders). The Treasurer's Disclosure Certificate is not intended to create any monetary rights on behalf of any person based upon the Rule.

DEPARTMENT'S DISCLOSURE CERTIFICATE

The Secretary of Veterans Affairs (the "Secretary"), on behalf of the Department, executed a Continuing Disclosure Certificate (the "Department's Disclosure Certificate") for the Offered Veterans G.O. Bonds. The following is a summary of the Department's Disclosure Certificate. Such summary is qualified by reference to the complete Department's Disclosure Certificate, which are available from the Department.

Certain Definitions

Defined terms used in the Department's Disclosure Certificate and not otherwise defined therein have the meanings set forth elsewhere in this Official Statement.

"**Annual Financial Information**" means, collectively, (1) financial information or operating data applicable to the Department's most recent Fiscal Year on and after the fiscal year ending on or after June 30, 2005 of the types included in this Official Statement in EXHIBIT 2 to APPENDIX B thereto, and (2) the information regarding amendments to the Department's Disclosure Certificate required pursuant the Department's Disclosure Certificate. Annual Financial Information shall include Audited Financial Statements, if available, or Unaudited Financial Statements.

"**Audited Financial Statements**" means annual financial statements, if any, of the 1943 Fund, audited by such auditor as shall then be required or permitted by State law. Audited Financial Statements shall be prepared in accordance with GAAP applied on a consistent basis; *provided, however,* that the Department may from time to time, in order to comply with federal or State legal requirements, modify the basis upon which its financial statements are prepared. Notice of any such modification shall be provided to (i) the Trustee, (ii) either each NRMSIR or the MSRB, and (iii) the SID, and shall include a reference to the specific federal or State law or regulation describing such accounting basis.

"Beneficial Owner" means a beneficial owner of Subject Bonds, as determined pursuant to the Rule.

"Bonds" means, at any time, all of the State's then outstanding Offered Veterans G.O. Bonds, collectively.

"Fiscal Year" means that period established by the Department with respect to which its, as applicable, Audited Financial Statements or Unaudited Financial Statements are prepared. As of the date of the Department's Disclosure Certificate, the Department's Fiscal Year begins on July 1 and ends on June 30 of the next calendar year.

"**GAAP**" means generally accepted accounting principles as prescribed from time to time by the Financial Accounting Standards Board.

"Holders" means the registered owners of the Subject Bonds.

"MSRB" means the Municipal Securities Rulemaking Board established pursuant to Section 15B(b)(1) of the Securities Exchange Act of 1934, as amended.

"Notice" means written notice, sent for overnight delivery via the United States Postal Service or a private delivery service which provides evidence of delivery.

"Notice Address" means with respect to the Department:

State of California Department of Veterans Affairs of the State of California
1227 O Street
Sacramento, CA 95814
Attention: Bond Finance Division

"NRMSIR" means, at any time, a then-existing nationally recognized municipal securities information repository, as recognized from time to time by the SEC for the purposes referred to in the Rule.

"Official Statement" means the Official Statement relating to the issuance of the Subject Bonds.

"Rule" means the applicable provisions of Rule 15c2-12 promulgated by the SEC under the Securities Exchange Act of 1934, as amended (17 CFR Part 240, § 240.15c2-12), as in effect on the date of the Department's Disclosure Certificate, including any official interpretations thereof.

"SEC" means the United States Securities and Exchange Commission.

"Securities Counsel" means legal counsel expert in federal securities law.

"SID" means, at any time, a then-existing state information depository, if any, as operated or designated as such by or on behalf of the State of California and recognized by the SEC for the purposes referred to in the Rule.*

"Subject Bonds" means the Offered Veterans G.O. Bonds and those Veterans G.O. Bonds subject to the same Department's Disclosure Certificate.

"**Unaudited Financial Statements**" means the same as Audited Financial Statements, except that they shall not have been audited.

"Underwriters" means the respective underwriters in connection with the offering of the Subject Bonds.

* As of the date of this Official Statement, there is no SID.

Provision of Annual Financial Information

The Department shall provide Annual Financial Information with respect to each Fiscal Year to the State Treasurer and to each NRMSIR and the SID, by no later than the first day of the tenth calendar month after the end of such Fiscal Year.

The Department's Disclosure Certificate requires the Department to provide, in a timely manner, notice of any failure by it to provide Annual Financial Information to each NRMSIR and the SID on or before the date described in the first paragraph under this heading, to the SID, to the State Treasurer, and to either (i) each NRMSIR or (ii) the MSRB.

Annual Financial Information shall be provided at least annually, *notwithstanding* any Fiscal Year longer than 12 calendar months. The Department shall promptly notify the State Treasurer, the SID and either (i) each NRMSIR or (ii) the MSRB, of each change in its Fiscal Year.

It shall be sufficient for purposes of Department's Disclosure Certificate if the Department provides Annual Financial Information by specific reference to documents previously either (i) provided to each NRMSIR existing at the time of such reference and the SID or (ii) filed with the SEC. If such a document is a final official statement within the meaning of the Rule, it also must be available from the MSRB.

Annual Financial Information may be provided in one document or multiple documents, and at one time or in part from time to time.

If not provided as part of the Annual Financial Information by the date required, the Department shall provide Audited Financial Statements, when and if available, to the State Treasurer and to each NRMSIR and the SID.

Additional Disclosure Obligations.

The Department acknowledges in the Department's Disclosure Certificate that other state and federal laws, including but not limited to the Securities Act of 1933 and Rule 10b-5 promulgated under the Securities Exchange Act of 1934, may apply to the Department, and that under some circumstances compliance with the Department's Disclosure Certificate, without additional disclosures or other action, may not fully discharge all duties and obligations of the Department under such laws.

Additional Information

Nothing in the Department's Disclosure Certificate will be deemed to prevent the Department from disseminating any other information, using the means of dissemination set forth in such Department's Disclosure Certificate or any other means of communication, or including any other information in any Annual Financial Information, in addition to that which is required by the Department's Disclosure Certificate. If the Department chooses to include any information in any Annual Financial Information in addition to that which is specifically required by the Department's

Disclosure Certificate, the Department shall have no obligation under the Department's Disclosure Certificate to update such information or include it in any future Annual Financial Information.

Termination of Reporting Obligation

The Department's obligations under the Department's Disclosure Certificate with respect to the Subject Bonds terminate upon the legal defeasance, prior redemption, or payment in full of all of such Subject Bonds. The Department shall give notice of any such termination to the SID and to either each NRMSIR or the MSRB.

Department's Disclosure Certificate, or any provision thereof, shall be null and void to the extent set forth in an opinion of Securities Counsel obtained by the Department, and addressed to the Department and the State Treasurer, to the effect that those portions of the Rule which require the provisions of the Department's Disclosure Certificate, or any of such provisions, do not or no longer apply to any or all of the Subject Bonds, whether because such portions of the Rule are invalid, have been repealed, or otherwise, as shall be specified in such opinion, and delivers notice to such effect to the State Treasurer, to the SID and to either each NRMSIR or the MSRB.

Amendment of Department's Disclosure Certificate

The Department's Disclosure Certificate may be amended and any provision of the Department's Disclosure Certificate be waived, without the consent of the Holders or Beneficial Owners, except as described in clause 4 (ii) below, under the following conditions: (1) such amendment or waiver is made in connection with a change in circumstances that arises from a change in legal (including regulatory) requirements, a change in law (including rules or regulations) or in interpretations thereof, or a change in the identity, nature or status of the Department or the type of business conducted thereby, (2) the Department's Disclosure Certificate as so amended or waived would have complied with the requirements of the Rule as of the date of each primary offering of Subject Bonds affected by such amendment or waiver, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances, (3) the Department shall have obtained an opinion of Securities Counsel, addressed to the Department and the State Treasurer, to the same effect as set forth in clause (2) above, (4) either (i) a party unaffiliated with the Department (such as bond counsel), acceptable to the Department, has determined that the amendment or waiver does not materially impair the interests of the Beneficial Owners, or (ii) the applicable Holders consent to the amendment to or waiver of such Department's Disclosure Certificate, and (5) the Department shall have delivered copies of such amendment or waiver to the SID, to the State Treasurer, and to either each NRMSIR or the MSRB.

In addition to the foregoing, the Department may amend the Department's Disclosure Certificate, and any provision of the Department's Disclosure Certificate may be waived, if the Department shall have received an opinion of Securities Counsel, addressed to the Department and the State Treasurer, to the effect that the adoption and the terms of the amendment or waiver would not, in and of themselves, cause the undertakings in such Department's Disclosure Certificate to violate the Rule, taking into account any subsequent change in or official interpretation of the Rule.

To the extent any amendment to the Department's Disclosure Certificate results in a change in the type of financial information or operating data provided pursuant to the Department's Disclosure Certificate, the first Annual Financial Information provided thereafter shall include a narrative explanation of the reasons for the amendment, and the impact of the change.

If a change is made to the basis on which financial statements are prepared, the Annual Financial Information for the year in which the change is made shall present a comparison between the financial statements or information prepared on the basis of the new accounting principles and those prepared on the basis of the former accounting principles. Such comparison shall include a qualitative and, to the extent reasonably feasible, quantitative discussion of the differences in the accounting principles and the impact of the change in the accounting principles on the presentation of the financial information.

Benefit; Third-Party Beneficiaries; Enforcement

The provisions of the Department's Disclosure Certificate shall inure solely to the benefit of the Holders from time to time; *except* that Beneficial Owners shall be third-party beneficiaries of the Department's Disclosure Certificate.

Except as described in this paragraph, the provisions of the Department's Disclosure Certificate shall create no rights in any other person or entity. Except as limited by the succeeding sentence, the obligation of the Department to comply with the provisions of the Department's Disclosure Certificate shall be enforceable (i) in the case of enforcement of obligations to provide financial statements, financial information, operating data, and notices, by any Beneficial Owner of outstanding Subject Bonds, or (ii) in the case of challenges to the adequacy of the financial statements, financial information and operating data so provided, by the Holder of not less than 25% in aggregate principal amount of the Subject Bonds at the time outstanding.

The right to enforce the provisions of the Department's Disclosure Certificate shall be limited to a right, by action in mandamus or for specific performance, to compel performance of the Department's obligations under the Department's Disclosure Certificate. Any failure by the Department to perform in accordance with the shall not constitute a default or any Event of Default under the Subject Bonds, and the rights and remedies provided by the Subject Bonds upon the occurrence of a default or an Event of Default shall not apply to any such failure.

Governing Law

The Department's Disclosure Certificate will be construed and interpreted in accordance with the laws of the State, and any suits and actions arising out of the Department's Disclosure Certificate will be instituted in a court of competent jurisdiction in the State, *provided that,* to the extent such Department's Disclosure Certificate address matters of federal securities laws, including the Rule, the Department's Disclosure Certificate will be construed in accordance with such federal securities laws and official interpretations thereof.

APPENDIX E
CERTAIN FEDERAL TAX CODE REQUIREMENTS

The Federal Tax Code restricts the issuance of Federally tax-exempt bonds to finance mortgage loans for single family housing or to refund such bonds.

Those Federal Tax Code restrictions are not the same for all such tax-exempt bonds. There are three types of such tax-exempt bonds: (i) qualified mortgage bonds, which provide Qualified Mortgage Bond Proceeds, (ii) qualified veterans' mortgage bonds, which provide Qualified Veterans' Mortgage Bond Proceeds, and (iii) pre-Ullman bonds, which provide Unrestricted Moneys. Revenue Bonds may be either qualified mortgage bonds or pre-Ullman Bonds. ("Pre-Ullman bonds" are bonds issued before 1981, or bonds issued to refund such bonds.) Veterans G.O. Bonds may be either qualified veterans' mortgage bonds or pre-Ullman bonds. The principal Federal Tax Code restrictions relate to: (i) the use of proceeds of the bond issue, (ii) the yield on the financed mortgage loans and from certain non-mortgage investments related to the issue, (iii) for qualified mortgage bonds and qualified veterans' mortgage bonds, loan eligibility requirements, (iv) for qualified mortgage bonds, the availability of proceeds of the issue for financing housing located in "targeted areas," and (v) certain matters relating to the issue itself.

See "TAX MATTERS" for information regarding the requirements applicable to the Offered Veterans G.O. Bonds.

Failure to comply with the applicable provisions of the Federal Tax Code may result in interest on the applicable issue of bonds being included in gross income for federal income tax purposes retroactive to the date of issuance thereof.

Loan Eligibility Requirements Imposed by the Federal Tax Code on Qualified Mortgage Bond Proceeds and Qualified Veterans' Mortgage Bond Proceeds

Qualified Mortgage Bond Proceeds

The Federal Tax Code contains the following loan eligibility requirements with respect to Qualified Mortgage Bond Proceeds, except that the requirements described under "First-Time Homebuyer Requirement," "Purchase Price Limitation," and "Other Requirements Imposed by the Code – Recapture Provision" do not apply to home improvement loans, and the requirements described under "Qualified Home Improvement Loans" do not apply to loans for the acquisition of single family homes. None of those requirements applies to pre-Ullman bonds or qualified veterans' mortgage bonds.

Residence Requirement. The Federal Tax Code requires that each of the premises financed with the lendable proceeds of qualified mortgage bonds be a one-to-four-family residence, one unit of which can reasonably be expected to become the principal residence of the veteran within a reasonable time after the financing is provided. Certain documents adopted by the Department establish procedures to be followed in connection with Contracts of Purchase which finance the acquisition of single family homes in order to assure that interest paid on the qualified mortgage bonds not be included in gross income for Federal income tax purposes under the Federal Tax Code (the "Single Family Program Documents"). Certain documents adopted by the Department establish procedures to be followed in connection with Contracts of Purchase to finance home improvement loans intended to assure that interest paid on the qualified mortgage bonds is not included in gross income for Federal income tax purposes under the Federal Tax Code (the "Home Improvement Program Documents," together with the Single Family Program Documents, the "Program Documents"). In connection with the financing of a Contract of Purchase, the Program Documents require that each veteran submit an affidavit stating such person's intention to occupy the premises as his principal residence within 60 days after closing of the Contract of Purchase.

First-Time Homebuyer Requirement. The Federal Tax Code requires that, subject to certain exceptions, the lendable proceeds of qualified mortgage bonds be used to provide financing to borrowers who have not had a present ownership interest in their principal residence during the three-year period prior to execution of the mortgage loan. All financing with respect to targeted area residences and residences on land possessed under certain contract for deed agreements is treated as satisfying the first time homebuyer requirement. Veterans subject to this requirement are required to provide federal income tax returns for the previous three years or other appropriate certifications to allow verification that no deductions or other entries have been made that would indicate any such ownership interest.

New Mortgage Requirement. The Federal Tax Code requires that, with certain limited exceptions, the lendable proceeds of qualified mortgage bonds finance new mortgage loans only and that no proceeds may be used to acquire or replace an existing mortgage loan, which would include the refinancing of a pre-existing mortgage loan. The Program Documents state that the Department will verify compliance with the new mortgage requirement by requiring each veteran to certify prior to financing, subject to such exceptions, that no refinancing of a prior mortgage loan is being effected.

Purchase Price Limitation. The Federal Tax Code requires that the purchase price of the residence financed with the lendable proceeds of qualified mortgage bonds may not exceed 90% of the average area purchase price applicable to such residence or 110% of the applicable average area purchase price in the case of residences located in targeted areas. The Program Documents state that the Department will verify compliance with the purchase price limitations by requiring each veteran and seller of a residence to make certifications regarding the purchase price of such residence.

Income Limitation. The Federal Tax Code requires that all mortgage loans made from the lendable proceeds of qualified mortgage bonds be made only to borrowers whose family income does not exceed 115% (for mortgage loans made to families with fewer than three members, 100%) of the applicable median family income. An exception is provided for mortgage loans financed with the lendable proceeds of qualified mortgage bonds made with respect to targeted area residences that permits two-thirds in aggregate amount of such mortgage loans to be made with respect to borrowers whose family income does not exceed 140% (for mortgage loans made to families with fewer than three members, 120%) of the applicable median family income and one-third in aggregate amount of such loans to be made without regard to any income limitation.

Federal tax law permits higher income limits for persons financing homes located in certain "high housing cost areas." A high housing cost area is a statistical area for which the ratios of the area's average purchase price for existing and new single family houses to the area's median income exceed 120% of the same ratios determined on a national basis. These ratios are determined separately with respect to new and existing single family residences. An area is a high housing cost area only if the ratios for both new and existing houses meet the 120% test. In high housing cost areas, the veteran income limits are increased above 115% (or 100%, as applicable) by one percent for each percentage point (1%) by which the new or existing housing price ratio, whichever is smaller, exceeds 120%. However, the new limit cannot exceed 140% (or 120%, as applicable) of the income limits otherwise applicable. Certain areas of the State may qualify as high housing cost areas.

Family income includes income of all individuals executing both the note and mortgage and occupying the dwelling as their principal residence.

Requirements as to Assumptions. The Federal Tax Code provides that a mortgage loan may be assumed only if each of the then applicable residence requirements, first-time-homebuyer requirement, purchase price limitation, and income limitation is met with respect to such assumption. The Contracts of Purchase contain a "due on sale" clause, and the Program Documents state that the assumption of a Contract of Purchase should not be permitted unless these requirements have been met and the appropriate certifications have been obtained.

Qualified Home Improvement Loans. The Federal Tax Code requires that a home improvement loan financed with the lendable proceeds of qualified mortgage bonds not exceed $15,000, be made only with respect to an owner-occupied residence, and finance alterations, repairs, and improvements on or in connection with an existing one-to-four-family residence by the owner thereof, but only if such alterations, repairs and improvements substantially protect or improve the basic livability or energy efficiency of the property.

General. Qualified mortgage bonds treated under the Federal Tax Code as one bond issue for federal tax purposes ("qualified mortgage issue") are deemed to meet the loan eligibility requirements of the Federal Tax Code if (i) the issuer in good faith attempted to meet all the loan eligibility requirements before the mortgage loans were executed, (ii) any failure to comply with the loan eligibility requirements is corrected within a reasonable period after such failure is first discovered, and (iii) 95% or more of the proceeds of the issue used to make mortgage loans was used to finance residences that met all such requirements at the time the mortgage loans were executed. In determining whether 95% or more of the proceeds has been so used, the Federal Tax Code permits the Department to rely on an affidavit of the veteran and of the seller as to the purchase price of a residence and an affidavit of the veteran and an examination of copies of the veteran's Federal income tax returns for the last three years preceding the date the Contract of Purchase is or was executed even though the relevant information in such affidavits and income tax returns should ultimately prove to be untrue, unless the Department knows or has reason to believe that such information is false.

Qualified Veterans' Mortgage Bond Proceeds

The Federal Tax Code requires that each mortgagor to whom financing is provided under a qualified veterans' mortgage bond issue have served on active duty at some time before January 1, 1977 and apply for financing before the later of January 31, 1985 or the date which is 30 years after the last date on which the veteran left active service. The Department has established and has covenanted to comply with such requirements.

Generally, only the loan eligibility requirements stated above under "Qualified Mortgage Bond Proceeds – Residence Requirement," "– New Mortgage Requirement" and "– Qualified Home Improvement Loans" (*except* the $15,000 maximum loan amount) apply to Qualified Veterans' Mortgage Bond Proceeds.

Other Requirements Imposed by the Federal Tax Code

General. The Federal Tax Code provides that gross income for federal income tax purposes does not include interest on a mortgage revenue bond if it is a qualified mortgage bond or a qualified veterans' mortgage bond. A qualified mortgage bond is a part of an issue of a state or political subdivision all the proceeds of which (net of amounts applied to any costs of issuance thereof and to fund a reasonably required reserve) are used to finance (or to refund bonds all of such net proceeds of which were used to finance) owner-occupied residences and that meets certain (i) general requirements, (ii) arbitrage restrictions on the use and investment of proceeds of the issue, and (iii) loan eligibility requirements set forth in the Federal Tax Code and as more fully described above under "Loan Eligibility Requirements Imposed by the Federal Tax Code." A qualified veterans' mortgage bond is part of an issue 95 percent or more of the net proceeds of which are used to provide residences to veterans and that meets certain (i) general requirements, (ii) arbitrage restrictions on the use and investment of proceeds of the issue, and (iii) loan eligibility requirements set forth in the Federal Tax Code and as more fully described above under "Loan Eligibility Requirements Imposed by the Federal Tax Code."

Volume Limitation, Targeted Area and Required Reports. The first general requirement of the Federal Tax Code, applicable to qualified mortgage bonds, is that the aggregate amount of private activity bonds (exclusive of qualified veterans' mortgage bonds) that may be issued by the Department in any calendar year (or previous years' carried forward amount) must not exceed the portion of the private activity bond volume limit for the State for such calendar year that is allocated by the State to the Department. With respect to qualified veterans' mortgage bonds, a separate limit is based on statutory formulae. The second general requirement of the Federal Tax Code applicable to qualified mortgage bonds is that at least 20% of the lendable proceeds of an issue of bonds which are not refunding bonds (if such set-aside was satisfied with respect to the bonds being refunded) must be made available (and applied with reasonable diligence) for owner-financing of residences in targeted areas (as defined by the Federal Tax Code) for at least one year after the date on which such funds are first available for such owner-financing (the "targeted area requirement"). The third general requirement of the Federal Tax Code requires the issuer of qualified mortgage bonds and qualified veterans' mortgage bonds to file with the Internal Revenue Service reports on the issuance of its qualified mortgage bonds or qualified veterans mortgage bonds following such issuance, as well as an annual qualified mortgage loan information report.

Yield Limitations and Rebate. The Federal Tax Code requires that the effective interest rate on mortgage loans financed with the lendable proceeds of qualified mortgage bonds and qualified veterans' mortgage bonds may not exceed the yield on the issue by more than 1.125% (1.50% for pre-Ullman bonds), and that certain investment earnings on non-mortgage investments, calculated based upon the extent such investment earnings exceed the amount that would have been earned on such investments if the investments were invested at a yield equal to the yield on the issue, be rebated to the United States or to veterans. These requirements apply to both Revenue Bonds and Veterans G.O. Bonds, except that for Veterans G.O. Bonds, rebate, absent an election to pay to the United States, is to veterans. The Department has established procedures to determine the amount of excess earnings, if any, that must be rebated to the United States or to veterans. See APPENDIX B – "THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND" and "–THE PROGRAM – CONTRACTS OF PURCHASE" for discussions of provisions of the Veterans Code which affect the Department's ability to establish and to change interest rates on Contracts of Purchase.

Recapture Provision Applicable to Qualified Mortgage Bonds. For certain mortgage loans made after December 31, 1990 from the lendable proceeds of qualified mortgage bonds issued after August 15, 1986 (not including the Offered Veterans G.O. Bonds), and for assumptions of such mortgage loans, the Federal Tax Code requires a payment to the United States from certain borrowers upon sale or other disposition of their homes (the "Recapture Provision"). The Recapture Provision requires that an amount determined to be the subsidy provided by a qualified mortgage bond financing to a borrower be paid to the United States on disposition of the residence (but not in excess of 50% of the gain realized by the borrower). The recapture amount would (i) increase over the period of ownership, with full recapture occurring if the residence were sold between four and five full years after the closing of the mortgage loan and (ii) decline ratably to zero with respect to sales occurring between five and nine full years after the closing of the mortgage loan. An exception excludes from recapture part or all of the subsidy in the case of certain assisted individuals whose incomes are less than prescribed amounts at the time of the disposition. The Federal Tax Code requires an issuer to inform borrowers of certain information with respect to the Recapture Provision. The Program Documents include a form of notice and establish procedures to send such notice.

Required Redemptions. For qualified mortgage bonds issued after 1988, the Federal Tax Code permits repayments (including prepayments) of principal of mortgage loans financed with the proceeds of an issue of such bonds to be used to make additional mortgage loans for only 10 years from the date of issuance of the bonds (or the date of issuance of the original bonds in the case of refundings), after which date such amounts must be used to redeem bonds, except for a $250,000 *de minimis* amount. As a result, the Department is required by the Federal Tax Code to redeem Revenue Bonds which are qualified mortgage bonds from repayments (including prepayments) of principal of certain Contracts of Purchase not later than the close of the semi-annual period after the payment is received.

Compliance. The Federal Tax Code states that an issuer will be treated as meeting the targeted area requirement, the arbitrage restrictions on mortgage loans, and the recapture information requirements if it in good faith attempted to meet all such requirements and any failure to meet such requirements was due to inadvertent error after taking all reasonable steps to comply with such requirements.

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APPENDIX F
LEGAL OPINION OF ATTORNEY GENERAL

The Honorable Philip Angelides
State Treasurer
Sacramento, California

$221,475,000
State of California

Veterans General Obligation Bonds

$16,000,000 Series CA
$205,475,000 Series CB

Final Opinion

Honorable Philip Angelides:

We have acted as counsel to the State of California (the "State") in connection with the issuance by the State of $221,475,000 aggregate principal amount of State of California Veterans General Obligation Bonds, Series CA and $16,000,000 aggregate principal amount of State of California Veterans General Obligation Bonds, Series CB, dated April 1, 2005, issued under $205,475,000 Veterans Bond Acts, all identified in Schedule A hereto, which is incorporated by reference (collectively, the "Bonds"). The Bonds are authorized pursuant to (i) the Veterans Bond Acts identified in Schedule A, each of which was approved by the electors of the State (the "Bond Acts"), (ii) Part 3 of Division 4 of Title 2 of the California Government Code, and (iii) resolutions adopted by the Veterans Finance Committee of 1943 on March 28, 2005, identified in Schedule B hereto, which is incorporated by reference (the "Resolutions").

In such connection, we have examined the record of proceedings submitted to us relative to the issuance of the Bonds, including the Resolutions, certifications of the State, and such other documents and matters deemed necessary by us to render the opinions set forth herein, although in doing so, we have not undertaken to verify independently the accuracy of the factual matters represented, warranted or certified therein, and we have assumed the genuineness of all signatures thereto.

The opinions expressed herein are based upon an analysis of existing laws, regulations, rulings and court decisions and cover certain matters not directly addressed by such authorities. Such opinions may be affected by actions taken or omitted or events occurring after the date hereof. We have neither undertaken to determine, nor to inform any person, whether any such actions are taken or omitted or events do occur or whether any other matters come to our attention after the date hereof. Furthermore, we have assumed compliance with the agreements and covenants contained in the Resolutions. We call attention to the fact that the rights and obligations under the Bonds and the Resolutions may be subject to bankruptcy, insolvency, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors' rights, to the application of equitable principles, to the exercise of judicial discretion in appropriate cases, and to the limitations contained in State law regarding legal remedies against the State. We express no opinion as to whether interest on the Bonds is excluded from gross income for federal income tax purposes or exempt from State of California personal income taxes or as to any other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the Bonds. Finally, we undertake no responsibility for the accuracy, completeness or fairness of the Official Statement dated April 12, 2005, or other offering material relating to the Bonds and express no opinion with respect thereto.

Based on and subject to the foregoing, and in reliance thereon, as of the date hereof, we are of the opinion that the State has lawful authority for the issuance of the Bonds, and the Bonds constitute the valid and binding general obligations of the State payable in accordance with the Bond Acts from the General Fund of the State. The full faith and credit of the State of California are pledged to the punctual payment of the principal of and interest on the Bonds, as the principal and interest become due and payable.

Sincerely,

Deputy Attorney General

For BILL LOCKYER
Attorney General

Schedule A

Authorization

$16,000,000 principal amount of Veterans General Obligation Bonds, Series CA, authorized under the Veterans Bond Act of 1996.

$58,305,000 principal amount of Veterans General Obligation Bonds, Series CB authorized under the Veterans Bond Act of 1986.

$39,980,000 principal amount of Veterans General Obligation Bonds, Series CB authorized under the Veterans Bond Act of 1988.

$3,180,000 principal amount of Veterans General Obligation Bonds, Series CB authorized under the Veterans Bond Act of 1990.

$89,595,000 principal amount of Veterans General Obligation Bonds, Series CB authorized under the Veterans Bond Act of 1996.

$14,415,000 principal amount of Veterans General Obligation Bonds, Series CB authorized under the Veterans Bond Act of 2000.

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Schedule B

Bond Act	Resolution Number	Veterans Finance Committee Date of Adoption
2000	I	March 28, 2005
1996	V	March 28, 2005
1990	X	March 28, 2005
1988	X	March 28, 2005
1986	XVII	March 28, 2005

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APPENDIX G
LEGAL OPINION OF BOND COUNSEL TO THE STATE

[CLOSING DATE]

Office of the Treasurer
of the State of California
915 Capitol Mall, Room 235
Sacramento, California 95814

Ladies and Gentlemen:

We have acted as bond counsel to the State of California (the "State"), and in such capacity we have examined upon request copies of proceedings taken by the State in connection with the issuance of the State's $16,000,000 aggregate principal amount Veterans General Obligation Bonds, Series CA (the "Series CA Bonds") and $205,475,000 aggregate principal amount Veterans General Obligation Bonds, Series CB (the "Series CB Bonds," and together with the Series CA Bonds, the "Series CA and CB Bonds") and the sale of the Series CA and CB Bonds to the initial purchasers thereof. The Series CA and CB Bonds are issued pursuant to (i) the Veterans Bond Acts identified in Schedule A hereto (collectively the "Law"), which is incorporated by reference, each of which was approved by the electors of the State, (ii) Part 3 of Division 4 of Title 2 of the California Government Code, and (iii) resolutions (the "Resolutions") adopted by the Veterans Finance Committee of 1943 on March 28, 2005, identified in Schedule B hereto, which is incorporated by reference.

The Series CA and CB Bonds are dated, mature on the dates in the principal amounts, bear interest, if any, and are payable as provided in the Resolutions. The Series CA and CB Bonds are subject to redemption prior to maturity in whole or in part as provided in the Resolutions.

The Department of Veterans Affairs of the State of California (the "Department") intends to issue its Home Purchase Revenue Bonds, 2005 Series A (the "2005 Revenue Bonds") in April 2005. The Series CA and CB Bonds and the 2005 Revenue Bonds are treated as a single issue for certain federal tax purposes under the Internal Revenue Code of 1986, as amended (the "Code"). Applicable federal tax law establishes certain requirements that must be met subsequent to the issuance of the Series CA and CB Bonds and the 2005 Revenue Bonds in order that interest on the Series CA and CB Bonds not be included in gross income for Federal income tax purposes under the Code. The Department has adopted documents with respect to its program (the "Program Documents") that establish procedures under which, if followed, such requirements can be met. The State and the Department have covenanted in the Resolutions and in tax certificates and other documents applicable to the issuance of the Series CA and CB Bonds and the 2005 Revenue Bonds (collectively with the Program Documents, the "Documents"), to at all times perform all acts and things permitted by law and necessary and desirable in order to assure that interest paid on the Series CA and CB Bonds shall not be included in gross income for federal income tax purposes under the Code. In rendering this opinion, we have relied upon such covenants and have assumed compliance by the State and the Department with the provisions of such Documents.

In connection with the issuance of the Series CA and CB Bonds, we have examined (a) a copy of the Resolutions, and (b) such other opinions, documents, certificates and letters as we deem relevant and necessary in rendering this opinion.

From such examination, we are of the opinion that:

(1) The State has lawful authority for the issuance of the Series CA and CB Bonds, and the Series CA and CB Bonds constitute the valid and legally binding general obligations of the State payable in accordance with the Law from the General Fund of the State. The full faith and credit of the State of California are pledged for the punctual payment of the principal of and interest on the Series CA and CB Bonds.

(2) Under existing statutes and court decisions and assuming compliance with certain tax covenants described herein, (i) interest on the Series CA and CB Bonds is not included in gross income for Federal income tax purposes pursuant to Section 103 of the Code, and (ii) interest on the Series CA Bonds is not treated as a preference item for purposes of calculating the alternative minimum tax imposed on individuals and corporations under the Code; such interest, *however*, is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations. Interest on the Series CB Bonds is treated as a preference item for purposes of calculating the alternative minimum tax imposed on individuals and corporations under the Code. No opinion as to exclusion from gross income of interest on any of the Bonds is expressed subsequent to any date on which action is taken pursuant to the Resolutions for which action the Resolutions require a legal opinion to the effect that taking such action will not adversely affect such exclusion, should the undersigned not deliver an opinion as of such date to such effect.

(3) Interest on the Series CA and CB Bonds is exempt from State personal income taxation under present State law.

In rendering this opinion, we express no opinion regarding any other Federal or state tax consequences with respect to the Series CA and CB Bonds. We render this opinion under existing statutes and court decisions as of the issue date, and assume no obligation to update this opinion after the issue date to reflect any future action, fact or circumstance, or change in law or interpretation, or otherwise. In rendering this opinion, we express no opinion on the effect of any action taken after the date of the opinion or not taken in reliance upon an opinion of other counsel on the exclusion from gross income for Federal income tax purposes of interest on the Series CA and CB Bonds, or under state and local tax law. We undertake no responsibility for the accuracy, completeness or fairness of any official statement or other offering materials relating to the Bonds and express herein no opinion relating thereto.

In rendering this opinion, we are advising you that the enforceability of the Series CA and CB Bonds may be limited by bankruptcy, moratorium, insolvency, or other laws affecting creditors' rights or remedies and is subject to general principles of equity (regardless of whether such enforceability is considered in a proceeding in equity or at law).

Very truly yours,

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